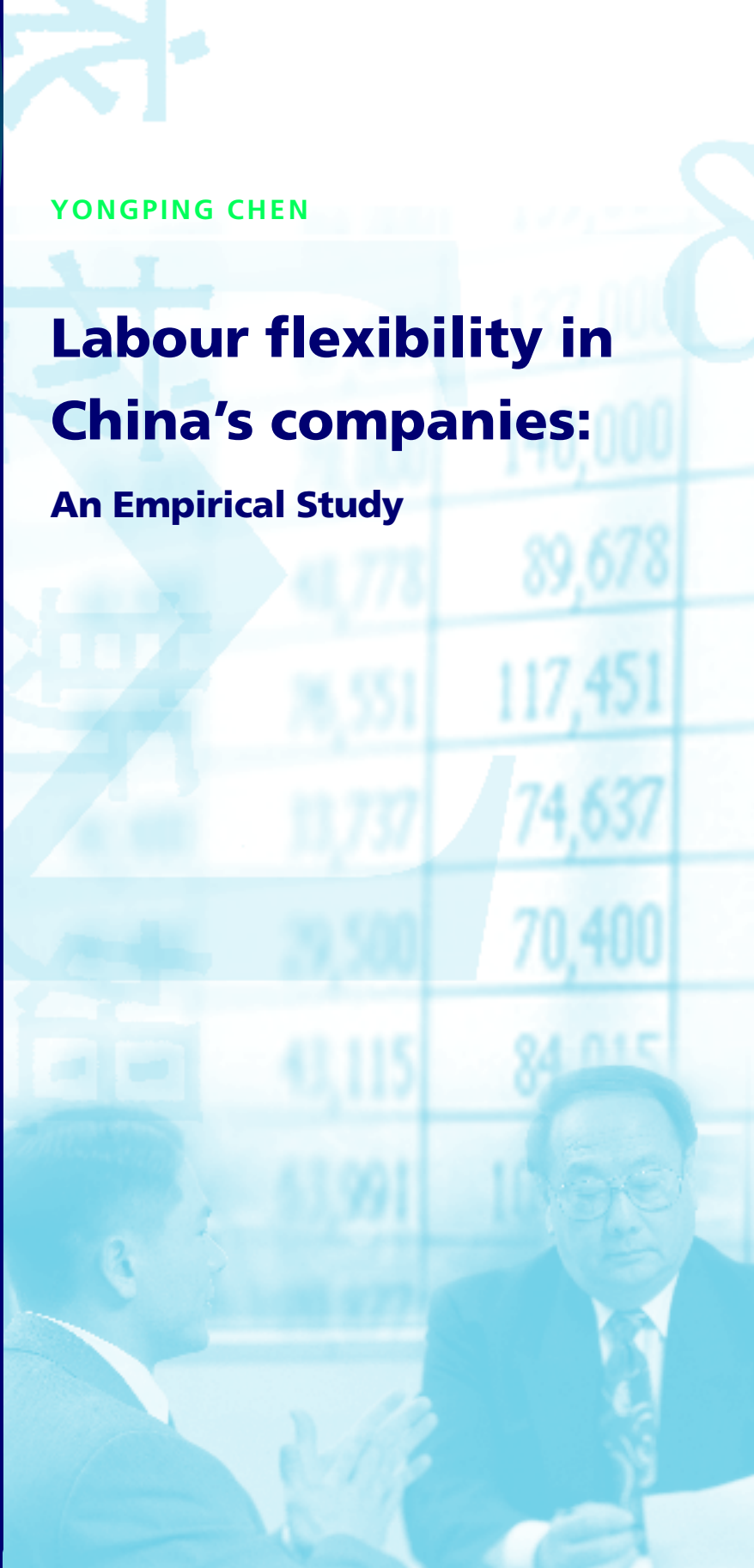
YONGPING CHEN

Labour flexibility in China's companies:

An Empirical Study



LABOUR FLEXIBILITY IN CHINA'S COMPANIES

AN EMPIRICAL STUDY

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AN EMPIRICAL STUDY

Flexibiliteit van de arbeid in Chinese bedrijven

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Yongping Chen

Rotterdam, June 2001.

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Chapter One

INTRODUCTION

Introduction

It has been more than two decades since China embarked on market-oriented transition in 1978. The adoption of liberal economic reforms and the 'open door' policy has consequently transformed one of the most isolated centrally planned economies in the world into a market-oriented economy. Most spectacularly, China's transition economy has successfully maintained fast economic growth over the past two decades. As industrial sectors in the 1990s are increasingly exposed to international competition, employment relations and human resource management (HRM) in companies are undergoing dramatic changes or reorientation towards flexibility.

This research intends to explore recent workplace practice changes with respect to the development of labour flexibility in manufacturing companies under China's transition context. Data presented in this research, unless stated, are empirical findings spaning up to 1997, using case study methods. It is an exploratory study that aims to provide an on-site *view* about the management of human resources at the company-level from the management perspective.

In this introductory chapter, the characteristics of China's transition economy are outlined and their implications for human resource management in companies briefly discussed (part 1). The research question is then presented for this study (part 2), and the justification of the study is discussed from the point of view of latest relevant research on China's HRM (part 3). This chapter ends with an overview of the content structure of the thesis (part 4).

1.1 China's transition economy: an overview

It is widely held that China's two decades (1978-97) of economic reforms drastically altered the country's economic landscape. At the macro-level, the centrally planned economy (mainly in the form of state ownership) gave way to the market economy, consisting of collective firms, Sino-foreign joint ventures, and private enterprises. Consequently, a plural structure of ownership of the economy has been established, with a fast growing non-state sector and a

declining state-sector. At the micro-level, nearly all economic actors can pursue their own profits, and have increasing freedom to adjust the workforce to market fluctuations, although in many areas their freedom to alter employment is still subject to government intervention (Walder, 1995). These macro- and micro- changes inevitably have significant impacts on the management of human resources at the company level (a theme of the study).

Before we come to the subject of the study, a brief review of China's transition economy is needed for a better understanding of changes and continuities in HRM in companies.

1.1.1 Impressive achievements

By any standard, China has achieved spectacular economic successes in the period 1978-1997. Table 1.1 shows some basic indicators of the impressive achievements in the economy. Over two decades, the country's GDP growth averaged 9.8 per cent, among the highest growth rates in the world. Per capita growth averaged almost 8.4 percent. Housing space per person was more than doubled in the first decade of reform, and doubled again in the second reform decade of 1988-1998. Individual ownership of consumer durable goods rose three- to fourfold (see SSB: 20-26, 1998). Private savings per capita have remained at 40 per cent of GDP since 1990, among the highest levels in the world. Robust foreign trade growth at 15 per cent was registered between 1980 and 1997. By 1995, China's economy was four times as large as it had been in 1980, five years earlier than the government goal of twice doubling the economy in the year 2000. Most significantly, fast economic growth has lifted 200 million Chinese people out of poverty, without major increases in inequality among residents. As a result, a steady improvement in living standards has been widely shared among the majority of Chinese people (World Bank, 1997). Particularly, the sustained high growth rate has generated millions of new jobs for newly grown labour entrants since 1978 (SSB, 1998: 156).

Table 1.1. Selected indicators of China's transition economy

	1978	1997	Average yearly % increase over 1979-97**
Population (million)	962.6	1,236.3	1.3
Labour force (million)	406.8	705.8	2.9
GDP* (RMB billion)	362.4	7477.2	9.8
GDP per capita* (RMB)	397.0	6079.0	8.4
Total exports and imports (US$ billion)	20.6	325.1	15.6
Individual saving deposits* (RMB billion)	21.1	4627.9	32.8
Average wage incomes of staff and workers* (RMB)	615.0	6470.0	4.2
Unemployment rate (per cent)	5.3	5.7	n.a.

Source: SSB 1998: 26; 38-40, 55, 127, 620; 1997: 411.
Note: * total value terms are calculated at current prices; ** growth rates are calculated at comparable prices. RMB = Chinese currency Renminbi (also in ¥), (1 UD$ = 8.09 ¥ in 1997).

It should be noted that China's sustained economic growth relied in large measure on the rapid expansion of the non-state sector that offset the shrinking state sector[1] by a greater margin (see Table 1.2). The restructuring of the state industrial sector has resulted in a sharp decline of the state ownership of industrial enterprises relative to the non-state firms during 1979--97. By 1997, the contribution of state-owned enterprises (SOEs) as a whole to total industrial output dropped to around 25 percent, from the height level of 78 per cent in 1979. Whereas non-state firms, that consist of collectives owned by communities or their own employees and, other categories of non-state firms (that had not even existed before 1978) rose to the share of three fourths in 1997. Although in heavy industry, as well as in areas of strategic importance such as energy and defense-related production, state-owned enterprises remain dominant (Child, 1994), non-state firms are present in almost all the lucrative areas of consumer industries such as pharmaceuticals and telecommunication.

With the thriving non-state sector and the diminishing state sector in the economy, a massive employment shift has occurred between state and non-state sectors: non-state industrial firms now employ 100 million workers, about the same employment size as in SOEs. Currently, the fast growing non-state sector has become an engine of the economy since the mid-1980s.

Table 1.2. China: share of gross industrial output value, by ownership, 1979-97

	State-owned	Non-state owned	Of the non-state owned		
	%	%	Collective %	Individuals %	Others %
1979	78.5	21.5	21.5	n.a.	n.a.
1980	76.0	24.0	23.5	0.0	0.5
1981	74.8	25.2	24.6	0.0	0.6
1982	74.4	25.6	24.8	0.1	0.7
1983	73.4	26.6	25.7	0.1	0.8
1984	69.1	30.5	29.7	0.2	1.0
1985	64.9	35.1	32.1	1.9	1.2
1986	62.3	37.7	33.5	2.8	1.5
1987	59.7	40.3	34.6	3.6	2.0
1988	56.1	43.2	36.2	4.3	2.7
1989	56.1	43.9	35.7	4.8	3.4
1990	54.6	45.4	35.6	5.4	4.4
1991	52.5	47.2	35.7	5.7	5.7
1992	48.1	51.9	38.0	6.8	7.1
1993	47.0	53.0	34.0	8.0	11.1
1994	37.3	62.7	37.7	10.1	14.8
1995	34.0	66.0	36.6	12.9	16.6
1996	28.5	71.5	39.4	15.5	16.6
1997	25.5	74.5	38.1	17.9	18.4

Source: SSB 1998: 433

[1] The shrinking state sector resulted from the 1990s corporatization of state firms into corporate governance under which the state only holds part of stakes (for details, see chapter 2).

1.1.2 A distinct approach

In contrast to the 'Big Bang' approach favored by other Transition Economies in Central and Eastern Europe (Lazear, 1995), China's transition economy features distinct incrementalist characteristics (McMillan and Naughton, 1996). First, the Chinese government, from the very beginning of reforms, subjected state-owned industrial enterprises to gradual restructuring, rather than exposing them to complete privatization (Naughton, 1994; Steinfield, 1998). Second, the government tolerated non-state firms thriving outside the state plans that eventually became the engineer of growth in the economy, as well as rivalry to state firms (Naughton, 1995a; Child, 1994). Third, the government advocated inflow of foreign direct investments (FDI) in the economy; while only limited industrial sectors and regions were selectively open to international competition (Howell, 1993; La Croix et al, 1995). Together, this controlled approach lends China's transition economy a momentum of dynamic growth without incurring severe disruption (McMillan, 1995; Walder, 1996). And this momentum of economic dynamic, though slowed down slightly in 1997-98 due to the Asian financial crisis, remains vibrant to date.

1.1.3 Implications for labour

Despite the incremental characteristics in the transition economy, China's business environment after the mid-1990s has changed into one that is quite different from a decade ago. As will be shown in chapter 2, big SOEs are downsized and corporatized. Small and medium sized SOEs are sold off or leased out to private hands with the latter promising to take over the employees (World Bank, 1997). Non-state firms are increasingly present in most industries. In a broad sense, reformed SOEs and non-state firms are now operating in the similar liberalized business environment. Goods in all sectors are now basically allocated through market transactions, and prices for the most part have been set on markets (Pyle, 1997). As a result, both state and non-state firms are competing with each other for survival and continued operations on markets.

As product market competition was further intensified in the mid-1990s, increasing market disciplines propel management to align the workforce (i.e. human resources) with market fluctuations and put them into flexible work arrangements. In the early 1980s, for instance, when state managers faced pressure to fulfill a state quota, they tended to seek supervising agencies for more slack resources including labour (Byrd and Tidrick, 1987). In the 1990s, managers tried to seek an alternative, for instance, by hiring extra temps who could be laid off as the market deteriorates (Howell, 1993; Benson, et al, 1998). As Warner (1995: 51) observes, "Labour plays both roles as a factor input and a stakeholder in the Chinese enterprise…. Workers want secure employment as well as decent rewards and benefits. Managers have their own agenda, seeking flexibility in the internal labour market in the enterprise. The desires of both parties sometimes match, sometimes conflict."

The shift to flexible employment lies in the fundamental characteristics of China's labour market where two distinct labour market segments are at work and have therefore different

implications for the firm's human resource policies and strategies. One labour market is the market where unskilled labour (including a large volume of migrant labour from the rural areas) is in excess supply, and where managers and firms need to find ways to hire and fire them flexibly in order to achieve higher mobility for cost effectiveness, using time contracts and differentiated wage rates. Another labour market concerns skilled labour that is relatively scarce in China. Here the management needs to find ways to attract and retain smart people by developing schemes of promotion, tenure, bonus, and stock options since their mobility and employability is high elsewhere. Therefore, the firm should keep smart people as the core of the workforce to elicit a long-term commitment.

Consequently, the management fears suffering losses of the core workers whose skills are vital to the firm's success, and/or avoid shedding them in the event of market downturn. Instead, firms tend to hire more contract workers who can be made redundant easily if there is a seasonal or cyclical drop in demand. A tendency of enterprises is to hire wage-workers from outside to bear the burden of adjustment to adverse conditions, leaving the "core" group of worker members intact. As McMillan and Naughton (1996: 171) observe: "When firms' autonomy increased, managers responded by strengthening the discipline imposed on workers. They increased the proportion of the workers' income paid in the form of bonuses and they increased the fraction of workers whom, being on fixed-term contracts, was, in principle, possible to fire". Therefore, "In less than one generation the Chinese manager has been faced with the need to be both entrepreneurial and skilled in business decision making." But they "must do so within a context of demanding social and welfare obligations and within greater inherent constraints in employment, redundancy and reward systems" (Brawn and Branine, 1996: 192).

1.2 Central research question and sub-specific questions

Given the intensifying market competition and the growing need for labour responsiveness, the central question to the research is: **how does management seek to increase *labour flexibility* in manufacturing companies in response to *increasing market competition* under *the changing institutional framework* in the transition economy?**

The central research question can be broken down into three specific sub-questions:

> *Q1. What types of labour flexibility are sought and achieved at workplace level?*
> *Q2. To what extent has the company's HR system changed to support workplace flexible practices?*
> *Q3. What institutional constraints or opportunities confront management in the attempt to increase labour flexibility in the company?*

Labour flexibility is highlighted because it has become a salient trend of the recent government labour reform efforts and an integral part of building-up a market economy (as will be elaborated in the next chapter). From a government perspective, flexibility in employment is seen as an effective way to eliminate employment rigidity prevailed in most SOEs. From a managerial viewpoint, labour flexibility implies enhanced management

discretion over the use of labour, especially when product market changes dictate prompt labour adjustments under a competitive business environment. From the employees' perspective, labour flexibility does not always mean employment insecurity. Except for fractions of the workforce with low skills and poor adaptability, low education achievements, and long attachment to a single enterprise, greater flexibility for those highly educated employees implies more freedom for mobility, more job opportunities in labour markets and, therefore, an improved work security. Hence, labour flexibility is not always a liability to workers, although it is more attractive to managers.

Increasing market competition is highlighted here because the entry of non-state firms has substantially intensified product market competition in China since 1990s. Intensified competition forces management to focus on the core business and profitability in rapidly changing markets. Without the core business, individual enterprises will be squeezed out of competitive product markets. Without profits, it is hard for enterprises to survive, let alone to continue operation as independent accounting units. Both the core business and the profitability, however, must be built upon on the firm's ability to attract qualified human resources that deliver flexibility and commitment. In other words, management has to address labour cost, quality, and employees' adaptability for the success of the firm in the competitive business environment. Flexibility of labour thus becomes the frontier of labour management whereby managers attempt to gain a competitive edge from the workforce

Hence, this research, by focusing on labour flexibility from the management perspective, attempts to explore ***what types of labour flexibility are sought and achieved at workplace level?***

For labour flexibility to be achieved at the workplace, there must be a set of supporting human resource (HR) practices and policies at the company level (Osterman, 1994b). This is so because, usually, the company's HR polices and practices set a scope for or limit to the development of labour flexibility at the workplace. These policies and practices, from the mainstream HRM perspectives, should be internally consistent, complementary, and coherently integrated into the business strategies of the company (Baron and Kreps, 1999).

A fundamental problem facing managers in both state and non-state enterprises in the pursuit of labour flexibility is **to what extent the company's HR system has changed to support workplace flexible practices.**

On the other hand, Chinese industrial enterprises are in general embedded in broad institution networks. Firms with different forms of ownership are thus linked in a differing degree with the past institutional legacies for bureaucratic control. Typically, state firms' human resource (HR) systems, as part of the past state socialist institutions, need to be transformed to support management's efforts to increase labour flexibility at the workplace under the changing business environment. Most probably, management in different enterprises is likely to meet different institutional constraints and opportunities when attempting to align HR policies and practices in a flexible manner to realise the business goals of the organization.

The third specific research question is to address **what institutional constraints or opportunities confront management in the attempt to increase labour flexibility in the company.**

It can be assumed that management's attempt to increase labour flexibility in the company is subject to various institutional constraints (or opportunities). The extent to which institutional constraints (or opportunities) impose on management varies largely with what is called 'path-dependency' of the enterprise (North, 1990) on the one hand, and the adaptability of the enterprise management to the changing institutional framework under the transition context on the other.

In what follows, this research is to be justified by a brief review of recent researches on China's human resource management.

1.3 Justification of the research

The relative success of China's transition economy has invited interested scholars to examine the impacts of the economic reforms on labour management in companies. Many scholars have attempted to examine changes in personnel management from different aspects: labour contract system (White, 1987a, 1987b); wages, bonuses and benefits (Guanhaw, 1985; Hu et al, 1988; Meng and Kidd, 1997); labour relations (Littler and Lockett, 1983; Lee, 1986; Warner, 1991); management decisions (Child, 1991, 1994; Lu and Child, 1996); and management development and training (Warner, 1985, 1987a, 1987b, 1992). But little attention was given to workplace practice changes with respect to labour flexibility.

The newly emerged HRM as a new approach to personnel management in the West in the late 1980s has triggered a wide discussion on the applicability of the Western HRM philosophy and practices in China. The topic is honoured by the fact that a large number of foreign-invested enterprises have already been set up in China, and many of these enterprises suffered personnel problems (Howell 1993; Murray 1994). Some believe that the underdeveloped Chinese labour market infrastructure is not ready for refined western HRM systems and practices (Warner, 1993). Some point out that the concept of HRM is not found in Chinese enterprises, even in Chinese companies outside the mainland of China, Western HRM practices are also alien to them (Child 1994). Others argue that HRM practices could be applied in China if they are properly modified with reference to local legal systems, culture, norms and beliefs (e.g.Verburg, 1996), since some differences in HRM practices were found mainly between joint ventures and Chinese state-owned enterprises (Verma and Yan, 1995). Despite no concluded consensus, it is clear that the Western scholars attempt to use the Western well-developed concepts to explain possible changes in personnel management in China's transition context.

As a labour contract system was introduced into the state sector in the mid-1980s, Korzec (1992) noted hindrances in implementing the labour contract system in state firms without radical changes in the party-state regime. Chan (1993) observed the growing antagonistic labour/management relations in both Chinese state firms and foreign invested joint

ventures. Warner (1996a) examined the latest progress of labour legislation in China, and the role of the new labour law in regulating industrial relations in companies. In the study of HRM in large SOEs in the industrial center of North-east China, Warner (1996b) found an increasing diversity among workers with respect to earnings, rewarding, and social fringe benefits. With the widening income differentials among workers, as well as between managers and employees that invoke increasing complaints and discontents, he foresaw that "a Chinese-style market economy is emerging, but the consequent structural changes are producing labour disputes and social costs." As a consequence, management has shown a tendency for combining Chinese characteristics with Western style practices pragmatically, in the enterprise (Warner 1996b: 7).

More recently, Goodall and Warner (1997), using a case-study approach, examined a set of HR practices (including labour contracts, rewards and benefits, social insurance, trade unions and personnel policies) in some large- and medium-sized joint ventures located in Shanghai and Beijing. They observed two 'hybrid' models of HRM prevailing in joint ventures: *mostly iron rice-bowl*[2] (i.e. the majority of HR practices were of the 'iron rice-bowl' type), and *mostly imported type* (i.e. the majority of HR practices were not of the 'iron rice-bowl type). They conclude that institutional and organizational inertia is manifested in the area of HRM practices in the joint ventures where characteristics of the 'iron rice-bowl' employment system from the Chinese partner-firms remain evident. The 'hybrid' model (i.e. elements of Western practice blended with older employment practices) is also evident in joint ventures situated in Shenzhen Special Economic Zone (Ding et al., 1997). The main reason for the lingering institutional inertia is that many joint ventures have been formed with and emerged out of an older SOE partner, and hence interlocked into some of their old structures and practices.

Warner (1999), in his latest study of China's hi-tech' firms in Beijing, notes that a new employment model is emerging in hi-tech firms with diffused or mixed ownership. By relating the degree of state ownership with the degree of institutional patron-client dependency, he predicts that the path of enterprise reform and accompanying organizational change would lead enterprises to move from classic *danwei*[3] 'ideal type' (i.e. high institutional dependency, and high state ownership), to one with low institutional dependency and high state ownership, finally ending up with low dependency and low state ownership. Again, Ding and Warner (1999) examine the impacts of China's latest reforms on industrial relations at enterprise level in both SOEs and foreign invested joint ventures in four cities. They conclude that the reforms of the early 1990s have 'reinvented' the industrial relation system and have significantly influenced recruitment and selection, wage and reward systems, and social security programmes.

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[2] "Iron rice-bowl" is a metaphor that was used to describe the pre-reformed Chinese employment system. Under 'iron rice-bowl', urban workers enjoyed jobs-for –life and a cradle-to-grave welfare safety-net (see Warner, 1996a: 780).

[3] Danwei is a basic work organization or unit in China (such as enterprises, government departments). It evolves as an institution which 'embodies deeply social, governmental and cultural practices and norms and that such institutions do not disappear easily but tend to reappear… [in] new guises under new economic and political conditions" (Fancis, 1996: 841).

Although institutional inertias are a set back to the firm's move toward labour market practices, some conditions favouring innovations in the area of HRM are now coming into play. As will be shown in the next chapter, many personnel decisions have been delegated to enterprise managers, even in large state-owned firms (Child 1994). And some new market institutions have been set up to recruit labour, such as the Labour Service Corporations and exchange centre for skilled workers and professional and technical staff (Howell, 1993). Moreover, some overmanned state firms are encouraged to establish non-state subsidiaries to explore a market niche in the hope that the redundant workers can be resettled separately. More commonly, state firms tend to establish joint ventures with foreign investors, where more preferential policies can be enjoyed and more flexible employment can be pursued (Pan 1996; Ma 1996). It has been demonstrated that foreign-invested joint ventures have in many cases succeeded in introducing more flexible employment arrangements (Benson et al, 1998), albeit initial opposition, and achieved a great economic success (Child 1994).

Clearly, most of the current research on HRM in today's China has focused on company level personnel activities (Child, 1994; Verma and Yan, 1995; Verburg, 1998), or changes in personnel management with the past as a benchmark (Warner, 1997; 1999; Han and Morishima, 1992). Little research has been done at the workplace level to capture workplace practice changes in the organization of work. Particularly, most scholars either chose state firms as their targets for investigations (Warner, 1995; 1997; Zhao and Nichols, 1996), or foreign-invested joint ventures for case studies (Verburg, 1996; Ding et al, 1997; Lu and Bjorkman, 1997; Goodall and Warner, 1997). Hence, more efforts are seemingly called for to make a comparative study of HRM practices at the workplace level between state firms and non-state firms (including foreign-invested joint ventures) in the same industry.

This research focuses on workplace practice changes toward labour flexibility from the management perspective. It distinguishes in the workplace, enterprise, and institution levels of HRM activities with respect to the development of labour flexibility. It is assumed that the firm operating in the market-oriented transition context as in China needs a workforce flexible enough to survive the intensifying product market competition. Accordingly, the firm's HR policies and practices must be consistent with each other internally to generate supporting HR systems for management to pursue labour flexibility in companies. More specifically, flexible work practices at the workplace rely on the company's consistent HR system that can maintain a dynamic manpower flow from which most valuable personnel will be retained in the organization. However, management's attempt to increase labour flexibility in the enterprise is subject to the changing institutional framework due to de- and re-institutionalisation in the transition economy that offers, in the most of time, ambiguous rules of the games to management in enterprises (Tan and Litschert 1994). On other hand, ambiguity in the rules of the game as characterized in the transition economy as in China may imply undiscovered opportunities for management to explore alternative employment practices under institutional constraints (Grabher and Stark, 1997). It is hoped that through this exploratory study, more detailed changes in HRM at the workplace level can be outlined in companies.

1.4 Overview of the thesis structure

This thesis consists of eight chapters. The structure of the thesis is depicted in the Figure 1.2 (see next page). Following the introductory chapter, chapter 2 presents five fundamental elements in China's transition economy, and how the transition in the economy has brought about changes and continuities in labour management in companies. Chapter 3 clarifies conceptual issues of labour flexibility and consistency in HR systems that have been discussed in the literature. The purpose of the chapter was to set up an analytic framework for a study of labour flexibility in the context of China, with reference to relevant theoretical perspectives.

Chapter 4 is concerned with the research design, methodology and data. In this chapter, there is a delineating how ten cases of manufacturing firms were chosen from three industrial sectors, guided by the analytic framework developed in chapter 3. Empirical data collected are then described and their reliability and validity discussed. This is followed by three empirical analysing chapters that comprise the core part of the research. In chapter 5, different types and forms of flexible work practices are examined and their applications to workers at the workplace described. The documented profiles of labour flexibility achieved at the workplace are discussed with reference to the firm's competitive strategies, product market position, ownership form, age, and location. Chapter 6 examines to what extent the company level's HR practices and policies (i.e. HR system) have changed consistently to support flexible work practices pursued at the workplace level. Here, the importance of the firm's ownership, age, and external institution constraints is highlighted as related to the findings on labour flexibility. Chapter 7 presents two special cases of SOEs engaged in downsizing in the declining machinery industry. The downsizing practices adopted in these two SOEs indicate how inconsistency inherent in the firm's HR policies undermines management's efforts to improve performance of the remaining workers after downsizing. Chapter 8 arrives at conclusions, by synthesizing the empirical findings in a broad institutional context. In so doing, the central research question raised in the first chapter is answered. In addition, a few areas for future research are indicated.

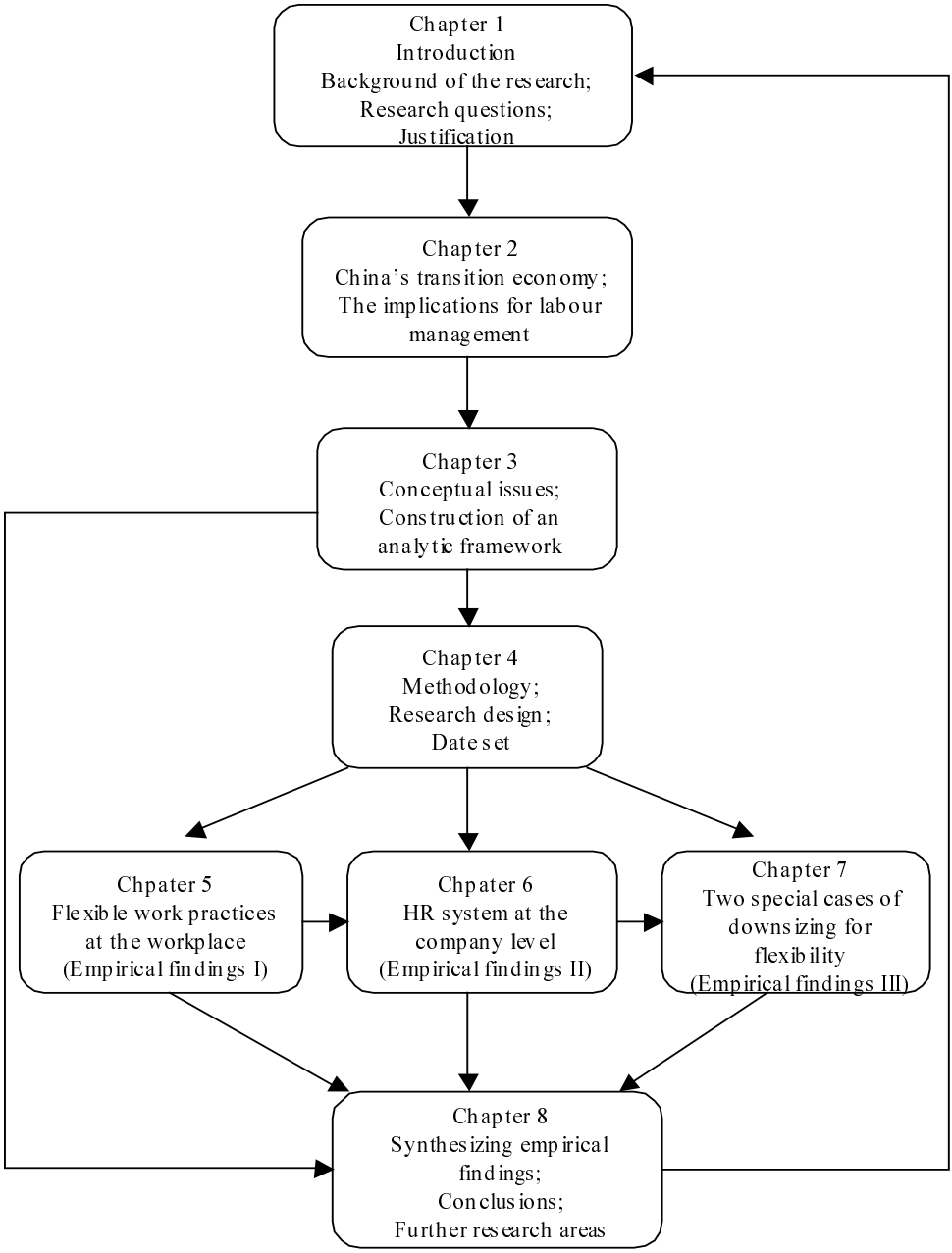

Figure 1.1. Overview of the dissertation structure: Chapters and their links

Chapter Two

Transition in China's Economy and its Implications for HRM in Companies

Introduction

This chapter sheds light on the background to the research. Three related issues are addressed here: (1) How was China's command economy transformed up to 1997[4]? (2) To what extent has the country's transition economy affected human resource (or labour) management in companies? And (3) what constraints still confront managers in their daily management of companies? The purpose of this chapter is to establish a backdrop for the following empirical analysis of labour flexibility in companies in China's transition context.

The chapter consists of four sections. The first section outlines five fundamental elements in China's transition economy, and the resultant deinstitutionalization and reinstitutionalization in transforming the country's basic institutional framework. This is followed by an overview of key labour reform measures in relation to changes and continuities in labour management (section 2). Section 3 highlights changing labour institutions by locating the labour management regime in the broad industrial governance. This chapter ends with a discussion of the remaining constraints on the management of human resources in companies.

2.1 Five key elements in China's transition economy

As pointed out in Chapter 1, two fundamental policies ushered in China's economy to market-oriented transition: economic reforms, and the open-door policy. The economic system reform, aimed at eliminating rigidity of the Stalinist command system in the state sector, has given room to the non-state economy that flourishes outside the state control. The open-door policy, which was designed to attract foreign direct investment (FDI) into China, has invited multinational companies to compete with local Chinese firms in domestic markets. As a result, the country's business environment has been transformed

[4] This research covers changes in China's economy in general and HRM in particular up to 1997.

into one of increasing market elements and remaining state socialist legacies (or, as claimed by the Chinese government, as a "socialist market economy").

Among the changes that occurred during the transition process, five key elements can be singled out. They are (1) restructuring of state-owned enterprises (SOEs), (2) the entry of non-state firms, (3) the increasing role of foreign trade and foreign direct investment, (4) the creation of market institutions, and (5) the establishment of market supporting legal systems (McMilliam and Naughton, 1996). These elements are inevitably reshaping human resource management in companies.

2.1.1 Restructuring of SOEs

Restructuring of state-owned enterprises (SOEs) has been the central task of China's economic reforms. The strategy for restructuring SOEs was to introduce liberalization into the state sector without changing state ownership. The reform of SOEs was mainly aimed at: 1) improving poor performance of the majority SOEs; 2) making SOEs financially accountable under hardened budget constraints; and 3) promoting market transactions guided by market signals instead of state plans.

Briefly, restructuring of SOEs has experienced four stages, each with different policy focuses (see Figure 2.1).

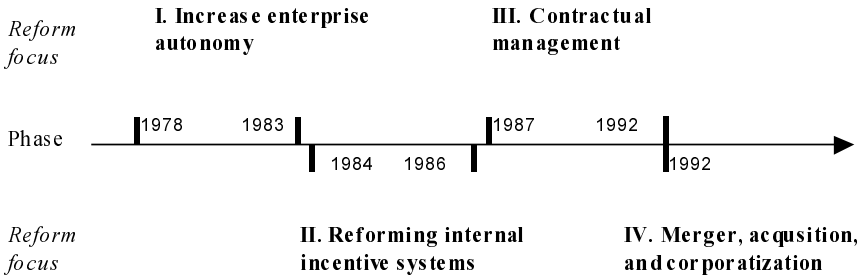

Figure 2.1. Four phases of reforming SOEs

The first stage (1979-83) started by enlarging enterprise autonomy. The main reform measures introduced at this stage included the delegation of some management powers from external government departments into the enterprise, and the introduction of the *profit retention* program (Fan, 1994). The retained profits above the quota delivery to the state could be used to reward workers in bonuses, benefits such as housing and health care, and investment in new plants. These measures unveiled the beginning of China's nationwide urban industrial reform.

In the second stage (1984-86) the reform effort shifted to forge appropriate internal incentives for improved performance. The *profit retention* program was replaced by a *profit taxation scheme* after taking into account the effects of price distortion and industry on a firm's profitability (Walder, 1987). The profit taxation scheme was designed to enable a firm to enjoy full marginal incentives for profit maximisation. Other reform initiatives adopted at this stage included "The Enterprise Bill of Rights" of May 1984, which was promulgated to give enterprise managers more precise autonomy in three key areas. These were (1) the authority of the enterprise manager to draw up the overall production plan inside the enterprise; (2) the increasing enterprise control over compensation of employees by linking total wage bill to profits; and (3) the long-term contracting over profit remittances between enterprises and their external supervisors. Detailed discussion of each of these measures can be found in Naughton's (1995a) work. It is important to note that at this stage market transactions were steadily introduced in enterprises, which enabled enterprise managers to respond to market forces.

During the third stage (1987-92) the Contract Management Responsibility System (CMRS) was formulated and implemented in most large and medium sized SOEs. The purpose of CMRS was to clarify the authority and responsibility of enterprise management and their supervisory agencies for a certain period of time (three to five years). The CMRS has several variants in practice, but the essence of the CMRS involves '*the two guarantees*' (i.e. the guaranteed amount of profit remittance, the guaranteed investment and technical innovation targets) and '*the single link'* (i.e. the increase of wage bills proportionate to total profits) (Fan, 1994; Child, 1994). It was hoped that relatively long-term management contracts would reduce the importance of '*ratchet effect'* (Naughton, 1995a: 213) by establishing a quasi-legal guarantee for the enterprise manager's autonomy over the contracted period of operations. And the contracting manager was expected to bear much higher levels of risk in exchange for higher compensation[5].

The fourth stage started from mid-1992 and extends up to the present. In the aftermath of the 1989 Tiananmen incident[6] and the subsequent economic retrenchment, stagnated economic reform was picked up by Deng's 1992 spring-tour to South China. On July 23, 1992, the State Council issued a new 'bill of rights' for SOEs, namely the "Regulations on Transforming the Operational Mechanism of State-Run Industrial Enterprises". The new regulations granted enterprises more specific autonomy in fourteen areas, including setting their own output prices, rights of hiring and firing labour, and allocating investment finances and fixed capital (see Child, 1994). In November 1993, a Communist Party plenum passed a historical resolution on the "Establishment of a Socialist Market Economy" as the ultimate goal of reforms in China.

More radical reform policies at this stage were formulated in 1994 and then after. These include mergers, acquisitions, leases, corporatization, worker and management buyouts,

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[5] For instance, some long-term contracts required a personal security deposit from the manager (Naughton, 1995a).

[6] Students initiated demonstrations for Western-style democracy and against government corruption in Beijing in early April, which culminated with the government crackdown of turmoil on 4 June 1989.

and bankruptcies[7] (Beijing Review, June1-7, 1998a). In particular, the government advocates '*strong to strong' firm mergers*, or large viable firms taking over ailing ones. This was mainly done through (1) the transformation of large and medium SOEs into limited liability companies (LLCs) and limited liability shareholding companies (LLSCs) according to the Company Law[8]; and (2) the establishment of 57 enterprise groups under central-level authority started in 1991 and accelerated in 1994 (World Bank, 1997: 33). As of 1996, approximately 5,800 industrial SOEs have become corporations (World Bank, 1997: 24). By doing so, market forces are expected to be in full play in promoting co-operation and competition between firms. It is also hoped that segmentation by bilateral jurisdictions or vertical administrative hierarchies will be broken off. In some regions, small and medium- sized state firms are increasingly leased out to entrepreneurs so that jobs and revenues could be maintained. In an extreme case, loss-making SOEs can go bankrupt, and scarce resources could be used more productively elsewhere (see World Bank, 1997: 4-9).

In the autumn 1997, the Chinese President Jiang Zemin announced tougher reform measures for revamping China's doddering state sector at the 15th Communist Party Congress. These measures were further elaborated by the new Prime Minister Zhu Rongji in his work plan addressed to the National People's Congress in the spring 1998. According to his ambitious plan, China's 300,000 plus state enterprises now in the red would be restructured into profitable ones through merges, bankruptcy, and sales to employees and other private investors. The state would then only retain control over 1,000 large state firms of strategic importance to form the mainstay of the economy (Beijing Review, 1998d).

At the same time, the focus of reform efforts was geared to reshape the governance structure of SOEs into corporations. The newly advocated corporate structure attempts to: 1) clarify asset rights, and assignment of liabilities, and 2) provide a reasonable balance of interests among owners, creditors, and managers. The former requires a clear separation: legally and operationally, between the government (as owner) and the firms (as business entities). The latter calls for a western corporate business system so that the owner can select a board of directors that, in turn, oversees the daily operations of the professional management.

In summary, the main enterprise reform measures in four stages – profit retention, profit

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[7] In the second half of 1997, mergers among Chinese enterprises reached a perk as five large state-owned firms became united. They are Donglian Petrochemical Group, Qilu Petrochemical Group, China Eastern Airlines, Haier Electrical Group, and Konka Electrical Appliances Giant (Beijing Review, June 1-7, 1998a: 13)

[8] The enactment of the Company Law in 1993 (effective in July 1994) is the most important legal development for the drive to establish SOEs as independent legal entities. Under Company Law, SOEs can be legally transformed into modern corporate forms of either *limited liability* or *share capital* so as to separate ownership from management as reflected in the typical west corporate governance structure. SOEs that were corporatized as separate legal entities have their own 'commercial' objectives, as well as autonomous rights and obligations under the Law.

taxation, the contract management system, and corporatization - were all directed at giving management sufficient discretion and powerful incentives to respond to market forces. The ultimate goal of the restructuring of the state sector was to create a 'level playing field' for SOEs vis-à-vis non-state firms. As McMillan (1995: 421) points out, "China shows the power of incentives; but it also shows that, in a transition economy, workable incentives can take surprisingly non-standard forms."

2.1.2 The entry of non-state firms

The most striking event in China's transition economy is the entry of non-state firms in parallel with the restructuring of SOEs since early 1980. Broadly, the non-state sector consists of collectives, private, and foreign-invested firms that grew outside the state plans. In the early phase of economic reforms, non-state firms emerged initially in response to the relaxation of the state monopoly over the economy, especially over industrial production and investment. Throughout the entire 1980s, the central government only relaxed the state monopoly over some industrial sectors where the shortage of supply prevailed in the economy (Kornai, 1980). Later on, a large number of start-up firms, especially rural township and village enterprises (TVEs), rushed to take advantage of large potential profits in the industrial sector (Byrd and Tidrick, 1987). Subsequently, local governments also sponsored many new start-up firms during the 1980s that were falling under state ownership (see Table 2.1). Despite administrative restrictions remaining, these new entrants (mainly non-state firms) grew quickly as entrepreneurial activities took root in the areas of many market niches left unfilled by the state firms under the old planning system (Naughton, 1995a). This is why the entry of non-state firms was most rapid in those sectors where profits were high in consumer goods manufacturing.

Table 2.1. Number of industrial enterprises by ownership (in 10,000 units)

	1992	1993	1994	1995	1996	1997
SOEs	10.33	10.47	10.22	11.80	11.38	9.86
Collectives	164.06	180.36	186.30	147.50	159.18	177.23
Private	685.40	797.12	800.74	568.82	621.07	597.47
Others*	1.42	3.21	4.45	6.03	7.02	7.73

Source: SSB 1997: 411; SSB 1998: 432. * Others = foreign-invested firms

It should be noted that non-state firms are largely market-oriented and operate outside the state plan (Nee, 1992). In particular, non-state firms usually employ relatively young employees, and adopt more flexible work practices. The result of their entry is a de facto division of competitive sectors with investment from non-state firms, and non-competitive[9]

[9] The non-competitive sector consists of the natural resource sectors and utilities, as well as the heavy materials industries (such as steel and industrial machinery) that are of strategic importance to the entire economy. It is in the non-competitive sector exhibiting substantial economies of scale that SOEs retain a monopoly or near-monopoly position. Whereas the

(or not fully competitive) sectors that continue to be dominated by state investment (Naughton, 1995b).

To some extent, the expansion of the non-state sector reflects the pragmatic attitudes of the Chinese government to the private economy, a taboo in its orthodox socialism. In the very beginning of economic reforms, the government merely tolerated, rather than encouraged, the development of private firms (Howell, 1993). The non-state economy was, for instance, defined, for the most part during the 1980s, as a '*conducive element' complementary* to the dominant state sector. Therefore, there were many restrictions (ranging from the scope of operations, size of employees, to bank loans) imposed on the expansion of non-state firms.

Table 2.2. Number of employees in industrial enterprises, by ownership (in million)

	1992	1993	1994	1995	1996	1997
SOEs	45.21	44.98	43.69	43.87	42.78	40.40
Collectives	18.62	17.00	16.04	15.03	14.29	13.27
Others	2.38	4.28	6.07	7.10	7.43	8.47
Total	66.21	66.26	65.80	66.10	64.50	62.15

Source: SSB 1997: 411; SSB 1998: 432.

As non-state firms exhibited increasing dynamics in value addition and job creation in the late 1980s and in the early 1990s (see Table 2.2), the government gradually dismantled some discriminating restrictions on private firms in some sectors. It was not until 1998 that the non-state economy was eventually recognized by the legislative body of National People's Congress as an *indispensable component* of the socialist market economy in the Constitution. By 1997, non-state industrial firms contributed 75 per cent to total industrial output, just the same proportion that SOEs produced two decades ago. Moreover, non-state firms have generated more than 70 per cent of industrial employment since 1985. Currently, the non-state sector has become a growth engine of the economy.

2.1.3 Increasing role of foreign trade and FDI

Another significant element distinguishing China from other transition economies is the increasing role of foreign trade and foreign direct investment in the economy. During the period 1991-1997, the country's foreign trade volume boomed swiftly from US$135.6 to US$ 325.1 billion (see Table 2.3). Most of the export growth came from increasing exports of manufactured products, which accounted for 86.9 per cent in 1997, among the world's ten largest trading powers. Given the fact that the country's 36.1 per cent of GDP exported to international markets in 1997, China's economy has been substantially integrated into

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competitive sector makes up of the remaining largest part of Chinese industry (e.g. pharmaceutical and telecom electronics) where non-state firms predominate and contribute 71 per cent of the output (Naughton, 1995b).

the global economy. By 1998, China's foreign trade surplus reserves exceed US$ 140 billion, the second largest reserves, after Japan, in the world (World Bank Annual Report 1999).

Table 2.3. Foreign trade and foreign direct investment, selected years

Item	1993	1994	1995	1996	1997
Total export and import (UD$ billion)	195.7	236.7	280.9	289.9	325.1
Exports	91.7	121.0	148.8	151.1	182.7
Imports	103.9	115.6	132.1	138.8	142.4
Balance	-12.2	5.4	16.7	12.2	40.3
FDI inflow	27.5	33.8	37.5	41.7	45.3
Number of registered foreign-funded firms (1000)	167.5	206.1	233.6	240.5	235.7

Source: SSB 1998: 620

Along with an upsurge in foreign trade and surplus revenues is the growing inflow of foreign direct investment (FDI) that culminated at US$ 54.8 billion in 1996. Prior to 1990, the effect of FDI as a whole was rather limited on the national economy. Because the annual inflow of FDI was below 6 per cent of total domestic fixed investment, and mainly concentrated in south China (i.e. Guangdong province) (Naughton, 1995a). After 1992, foreign investment surged to over 20 percent of total domestic fixed investment, culminating in 28.5 per cent in 1994, far from a negligible proportion. By September 1998, the total contractual amount of FDI arrived at US$ 556.9 billion, and utilized FDI came to US $ 253.7 billion (People's Daily, Nov. 2, 1998).

The influx of FDI has constituted an important component of China's transition economy. In the 1980s, the inflow of FDI was mainly concentrated in south China's four special economic zones (SEZs) (i.e. Shenzhen SEZ, Xiamen SEZ, Zhuhai SEZ, and Shantou SEZ). These SEZs are all close to Hong Kong and offered foreign investors special fiscal, infrastructure, and financial incentives. The fifth, in Hainan was added a decade later. The zones' success in attracting foreign investment, stimulating trade, and invigorating growth soon led to demands from other cities and provinces for similar arrangements. Beginning in the 1990s, local governments had a strong incentive to attract FDI into their jurisdictions. The host of more FDI in local economies not only generates more tax revenues and jobs; it also enhances the local government officials' position in bargaining with the center for more autonomy, as well as for their bureaucratic career promotion. Hence, the mid-1990s saw a new wave of the establishment of various industrial zones at local level for foreign investors.

With local governments racing to offer more preferential policies to foreign investors in the 1990s, more than 10, 000 economic zones had been established throughout China by 1998 (People's Daily, 1998). These industrial zones came in all shapes and sizes - economic and technological development zones, hi-tech development zones, open coastal cities, export processing zones, free trade zones, a financial zone, and free ports. Most of

the zones were located in the capital cities of the local jurisdictions of provinces (World Bank, 1997). The majority of FDI takes the form of equity joint ventures or in whole foreign enterprises. By the end of 1998, there were around 320,000 foreign-invested enterprises operating in almost every industrial sector (except for state defense) in China. Foreign invested firms as a whole have contributed to 40 per cent of the country's annual export since 1995, up from 12.6 per cent in 1990.

The FDI inflow, along with the increasing presence of foreign-invested enterprises, has brought China not only valuable investment capital, but also new technology, advanced equipment, and managerial know-how. Most significantly, foreign-invested companies, with high pay rates and less rigid employment practices, attract more and more qualified young employees from the ailing state firms. This in turn poses a great challenge to SOEs in the management of human resources.

2.1.4 Creation of market supporting institutions

With the economy continuing its vibrant momentum of growth, building market-supporting institutions comes into the forefront of market-oriented reforms. That is to say, "markets must start to operate where they did not exist before. New organizational forms must be improvised. Property rights must be defined and a law of contract instituted" (McMillan and Naughton, 1996: 7). Income and sales taxes must be designed. In short, market supporting macroeconomic institutions must be created.

Relaxing state monopoly. As noted above, one of the essential components in the planned system was the state's monopoly over industry, while the mid-1980s urban industrial reform started by relaxing state monopoly and permitting the entry of non-state firms. The presence of non-state firms in industry was extremely subversive to the planned system, subsequently leading to a powerful process of institutional changes. Initially, these newly created economic agents took the non-state ownership, often with strong market incentives, and competed with existing state-controlled firms. As a result, the state was forced to seek new incentive systems (e.g. CMRS) in the state sector in order to allow its agents to respond more effectively to new competitors.

Free pricing control. From the mid-1980s, the state gradually lifted its control over the pricing of industrial goods by introducing a "dual-track pricing system" (Pyle, 1997). Under the dual pricing system, the same industrial goods and inputs had two prices, one set by the state plan, and another on markets that was usually higher than the former. Consequently, firms were able to acquire inputs from two sources – a quota allocation at low prices (that is, plan), and additional amounts at higher, market prices. After fulfilling their plan quota, state firms were able to sell their products at higher, market prices. This dual-pricing environment created an untagged condition for rewarding entrepreneurs of using market opportunities, despite leading to corruption in the economy (Naughton, 1995b). Beginning in 1994, the state abolished its price-setting system. Most industrial product prices were determined in markets, and the state only controlled few key products (Fan, 1994). Today, prices become such an important market signal that the overall incentive mechanisms in state firms are rapidly transformed.

Capital markets. Beginning in the early 1990s, the pace of building market-supporting institutions accelerated after the stagnated reform of the 1989 Tiananmen incident. Two stock exchanges were established in Shanghai and Shenzhen in 1992, which marked the emerging capital market in China. Subsequently, a number of companies (mainly state firms) started to be listed on the two exchanges, and the "B" shares were opened to foreign investors. At the time of writing, the number of listed firms on the two exchanges exceeds one thousand in the mid-1999 (People's Daily, Sept. 17, 1999). The emergence of capital markets has yielded new opportunities for corporate control through acquisition or takeover on stock markets. The resultant corporate control, in turn, set some constraints on the growing insider control resulting from increased management autonomy.

Fiscal and tax reforms. Subsequently, fiscal and tax reforms were pushed ahead in 1994, with the focus placed on the separation of the central revenues from the locals. By dividing the sources of taxable base between the central and the local, the central government would be responsible for collecting all of the value-added tax (VAT), accounting for about 70 per cent of total tax. The center guaranteed that local revenues would not fall below 1993 revenue level for the next three years, but expects to take a larger share of increased revenues. The tax reform has re-centralized tax collection power in the center vis-à-vis locals. It represents a response of the central government to the declining fiscal revenue in 1990, or indeed throughout the 1980s (Wang, S. and Hu, A., 1996). Another main purpose of the tax reform was to create a "level playing field" for business firms that were differentiated by ownership and controlled by governments at different levels.

New investment regime. Following the fiscal and tax reforms there was a thrust to reform the investment system. First, the central government ceased financing state firms for new investments through fiscal grants or subsidies. Instead, all investment capital must be sought from and returned to banks. This shift mainly stemmed from the government attempts to hold down investment expansion of SOEs operated under soft budget constraints. Throughout the entire 1980s, investment capital in most SOEs came from two kinds of sources: "grant loans" from the government's fiscal system, and "bank loans" from the state bank's own deposits (Walder, 1989). Both investment sources were actually subjected to the government fiats and lacking sound economic grounds. Therefore, no ambitious manager would turn down an opportunity to expand his firm, driven by 'investment hungry' (Kornai, 1980). Second, the central government reoriented investment priorities out of its fiscal revenues to infrastructure provision and strategic industrial sectors that entail government supports (Naughton, 1995b). Competitive business investment activities would be left to firms themselves. From 1995, investment grants from fiscal revenues were gradually abolished. Instead, the central government deposited grant-loans in local state bank branches and managed by banks. Enterprises must either pay back these grant loans out of increased profits from expansion, or finance expansion through banking loans. In either case, governments no longer bailed out the failure of enterprises in investment financed by banks. The alternative left for viable firms to expand is to merger if expansion through investment is thwarted.

New banking systems. In collaboration with efforts to create a new investment regime, the old banking system was transformed in 1994 through a separation of commercial goals from the government fiscal policy functions. The government-directed lending would be

concentrated in newly set up "policy banks", including the National Development Bank, the Export-Import Credit Bank, and the Agricultural Development Bank. The existing four state banks (Bank of China, Agricultural Bank of China, People's Construction Bank of China, and Industrial and Commercial Bank of China) were converted into commercial banks operating on pure commercial criteria in the western sense. The People's Bank of China was divested itself from policy lending decisions and assumes the functions of the Central Bank. A Monetary Policy Commission was established to direct the central bank policy, and to regulate other commercial banks, using standard central bank tools such as reserve ratios, open market operations, and central bank lending. The objective of bank reform was to convert the banking system into an independent market system. Another related objective was aimed at hardening budget constraints on SOEs that were persistently dependent on state banks for survival.

Foreign exchanges. Another striking financial reform was made in the field of foreign payments. The dual-exchange rate of the Chinese currency that arose in the mid-1980s was replaced by a unified exchange rate based on market rates from January 1, 1994. The currency swap centers were to be abolished, and the partial convertibility of Chinese currency was to be established with the banking system. With a unified national exchange rate, issued daily by the Central Bank according to market rates, authorized individuals and firms are able to buy foreign exchanges at any designated bank. This reform is particularly welcomed by foreign investors, as well as by domestic firms with foreign trading relationships.

Establishing State Asset Management Company. In the race to corporatize SOEs into joint-stock companies that started in 1995, a multi-tiered organizational network of *state asset management institutions* has begun to emerge at different administrative levels. Among them, the newly created State Asset Management Company usually has a network of national, provincial, municipal and district levels. At each level of government, there are three tiers: (a) an 'upper-tier' organization, which represents the State as owner, usually through an executive body; (b) an 'intermediate organization', which is entrusted by the upper-tier institution to manage state assets; and (c) the 'operational enterprises', i.e. SOEs (World Bank, 1997). The main function of these institutions is to manage state assets in joint-stock companies, of which the State has a stake. They are expected to operate on commercial grounds, independent of the past supervising state agencies. Other functions of these state asset management institutions include the appointment of top managerial candidates in joint stock companies, assessment of top management performance, and the setting of reward standards for top management.

It is clear that the Chinese government has made great efforts in building up market-supporting institutions, although these are far from perfect. Such commitment to creating market institutions was accelerated recently as market-oriented reforms proceed in depth in the mid-1990. Although markets themselves are living institutions, which need rules and customs in order to work (McMillan and Naughton, 1996), the required market rules and customs cannot be evolved spontaneously without the government involvement, especially in a county like China.

2.1.5 Building up a market supporting legal framework

In the eyes of most Western scholars, China's sustained economic growth has taken place in a legal vacuum. As Clarke (1994) notes, "legal institutions remain essentially unreformed and ill-suited to the institutions of a market economy," and "property rights and contract rights are not well defined and reliably enforce." In effect, the Chinese government since 1978 has enacted a number of market compatible laws for regulating business activities within the rule of the game. Among them, Sino-Foreign Joint Venture Law was initially enacted in 1979, and amended again in 1993. Later on, the Company Law was promulgated in 1994 to set out a corporate framework for domestic firms. The Bank Law was enacted in 1994 for formalizing the banking activities. The Labour Law was endorsed in 1994 and took effect on May 1, 1995. Another important law is the Contract Law that was recently passed by the National Congress in the early 1998, and came to effect in 1999.

> "The legislative agenda of the Standing Committee of the Eighth National People's Congress (for 1993-98) comprises over 150 pieces of legislation, many of which support the establishment of the Socialist Market Economy. Critical pieces of legislation enacted recently are the Company Law (1993), Central and Commercial Banking Laws (1995), and the Security Law (1995). Other key pieces of the legislative puzzle, including a new State Asset Management Law and revised Contract and Insolvency legislation, are on the drawing board.
> Earlier important enactment includes the Economic Contract Law (1981 and revised in 1993), the Foreign Economic Contract Law (1985), the Trademark Law (1982) and the Patent Law (1984)." (World Bank, 1997: 19)

It cannot be denied that the government has recognized roles of a sound legal framework in facilitating entrepreneurial incentives, and improving economic efficiency. Company Law, for instance, by defining different forms of property and assignment of property rights to different owners, enables the entry and exit of firms. The Contract Law sets the 'rules of the game' for transactions, thus ensuring the efficient settlement of disputes arising in transactions. Obviously, a sound legal framework would provide economic agents with a "level playing field" that allows for competition to thrive and mitigate the importance of informal network and political connections.

Despite the great progress in legislation, it cannot be claimed that a sound legal foundation has been set up for a well-functioning market economy in China. The continuing arbitrary power of the Communist Party, as will be illustrated in the remaining chapters, sometimes clashes with the principle of equal treatment under laws. Despite these flaws, the newly created market institutions and laws start to regulate behaviour of firms.

2.1.6 Summary and concluding remarks

Five elements outlined above have substantially transformed China's business environment into one that characterizes competition, complexity, and uncertainty. Restructuring state-owned enterprises, by introducing new incentives and reshaping internal governance, has converted SOEs into a diffuse ownership and shared governance, as we shall see later. The entry of non-state firms into industry has brought a new engine into the economy. Accompanying their entry is the increasing competition that poses great pressure on SOEs for efficiency improvements. The influx of FDI and the growing number of foreigner-invested firms further intensify domestic market competition. In a relatively short time, Chinese firms have had to compete with multinationals for survival and continued operations on markets. At the same time, building market supporting institutions and legal systems is steadily under way, although far from complete. The established market institutions and legal systems provide some rules for market transactions, while they are still subject to the heavy hands of the government.

Apparently, a successful transition from state socialism entails processes of deinstitutionalization and reinstitutionalization. Deinstitutionalization requires that some of the existing institutions inherited from the centrally planned system must be demolished. This should be followed by reinstitutionalization, which means a set of market compatible new institutions must be created to accommodate economic agents under the changed business environment.

However, the transition economy must deal, at least temporarily, with the institutions left over from the planned economy in order to prevent catastrophic institutional vacuum (Hausner, et al, 1995). This is so partly because old institutions cannot be discarded until market-supporting institutions take their place; and partly because market institutions cannot automatically evolve, without the commitment of the government. It is not surprising that the collapse of state socialism in Eastern Europe led to informal and inter-firm networks functioning across enterprises and local organizations in institutional vacuum (Stark, 1995). The difficulty of building up new institutions that aim to limit the discretionary power of individuals lies in the fact that "…the application of these institutions is expected to be impartial, there is little scope for bargaining and compromise in the implementation process" (Naughton, 1995a: 302).

It can be expected that revamping an old institution system in China will certainly not be an easy task without resistances. This is particularly true when the microeconomic institutions as well as the macroeconomic system rooted in the planned system must all be changed. The difficulty in replacing old institutions (i.e. desinstitutionalization) stems from the fact that the planned economy system is an integral whole (McMillan and Naughton, 1996). And an attempt to remove certain crucial constituent elements may easily cause the whole edifice to tumble. This implies that any given reform measure might be useless or even counterproductive if introduced in isolation. Reform measures would have beneficial effects only if they were introduced as part of a package of reforms.

2.2 Changes and continuities in labour management

The above section outlined some fundamental changes that occurred in the economy since economic reforms in 1978. This section will turn to examine how the transition in the economy has posed impacts on labour management in companies.

2.2.1 Pre-reform scenario: labour and management in SOEs

China had unique labour management institutions that were inherited from the past centrally planned system. Industrial enterprises, mainly state-owned firms, were located in the complex networks of industrial institutions. Under such circumstance, both management and labour were substantially circumscribed to factors of production and dictated by the state plan.

The role of labour. Prior to 1978, labour played a role of factor-input and stakeholder in state-owned enterprises (SOEs). Workers were illusively praised as 'masters of the house'. They were assigned to the enterprise by outside Labour or Personnel Bureau, according to the state plan. Neither workers nor enterprises had much say over job assignments. Workers expected to spend their lives in the assigned enterprise when they left school. Their welfare benefits were provided by their enterprise that ranged from housing, medical cares, kindergarten, and pension (Guanhaw, 1985). For the enterprise, labour virtually became a fixed cost, since workers could not be fired without special reasons. Because workers were guaranteed jobs for life, they were not worried about losing jobs except for political reasons or gross negligence. The tool of dismissal or firing could not be used as the form of managerial control (Lockett, 1990). As a result, a rigid employment relationship evolved between the employees and their enterprise.

The role of managers. Managers, then factory directors, had no autonomy over operations of their firms. What they were expected to do was to follow directives from the government supervising agencies (Lockett, 1983). State agencies provided state firms with needed production inputs according to the state plans, and outputs were then procured by the state. There was no room left for entrepreneurial activities (Walder, 1986). Managers' salaries were fixed by above and not much higher than those of skilled workers. Although some managers were appointed from outside the firm, most of them spent long periods of time with one firm (Laaksonen, 1988). As such, managers tended to identify themselves with the workers' interest through the provision of a wider range of social welfare (Warner, 1985; Walder, 1987).

Means of motivation. Pay was not an effective motivating factor as wage scales were fixed nationally (Guanhaw, 1985). Promotions from one grade to another followed fairly strict national guidelines (Liu and Child, 1996). Skill related training was rare, and if any, usually organized by the local Industrial Bureau (Warner, 1985). Enterprise management had limited control over rewards, either through housing distribution based on seniority, or by granting a status for model workers that included some material benefits such as higher pensions and free trips (Gao, 1996). Attempts to motivate workers through ideology and

politics were less and less effective as material incentives were more valued. In most cases, managers had to rely on normative commitment to overall goals of development (see Table 2.4). The lack of labour discipline and motivation gave rise to widespread job shirking, low morale, and high absenteeism at the workplace (Lockett, 1990).

Table 2.4. Summary of the characteristics of the old employment system ("iron rice-bowl")

Employment	Life-time employment for urban workers; 'cradle-to-grave' welfare coverage; enterprises not permitted to sack
Incentives and rewards	Egalitarian but: age, length of service, loyalty carrying weights; Non-material rewards but spiritual motivation; 8-grade system for labour and 16-grade for management; Enterprise provision of housing, schooling, medical care
Performance management	Moral exhortation; Group rewards
Social security	Administered by enterprise; Non-contributory for workers
Trade union	Controlled by Party; Role of "transmission belt"
Workers Congress	Controlled by Party members; Workers as 'masters of the house'
Personnel department	Administration; Control of personal files, conformity, discipline, punishment
Labour market	No labour market; Centrally planned job allocation

Source: with reference to Goodall and Warner (1997: 571)

2.2.2 Key labour reform measures and institutional changes

Labour reform in SOEs started in the mid-1980s. It was inspired by the success of more flexible employment relations in non-state firms (Howell, 1993). Key reforms measures adopted so far include: the introduction of labour contract system, linking wages and bonuses to both the enterprise and individuals' performance, wage determination within the enterprise, and cutting redundant workers. Along with these reform measures are substantial changes in labour institutions. The ultimate goal of the reform was to establish market-based labour allocation and wage-setting mechanism in SOEs, representing a sharp break with the orthodox state socialism

2.2.2.1 Introducing the contract labour system

The labour contract system, first pioneered in the Shenzhen Special Economic Zone (SSEZ) in 1983, was designed to smash the '*iron rice bowl*' in the state sector (Warner, 1995). Choosing Shenzhen as an experiment site was simply because "Shenzhen could comfortably take the lead in this reform as it had no pre-existing workforce which could resist the reform" (Howell, 1993: 211). Initially, a contractual employment program of five-year contracts was mainly applied to some newly hired 'permanent' workers in SOEs,

whereas the existing employees in the state sector retained their status quo of lifetime jobs. As such, a '*two-track'* employment system was created in SOEs (Naughton, 1995a). Striking progress was made in 1992-93 as the labour contract system was extended to cover the existing employees in state firms and collective firms. This was mainly carried out by converting the previously permanent employees into contract workers. The duration of contract could vary from one to five years, corresponding to workers' previously accumulated service years. The principle of contract applied to both workers and managerial staff, thus leading to the demolition of the demarcation line between manual workers and managerial cadres.

Table 2.5. Number of contract workers and staff out of the total employees (in million and percentage)

	State-owned units	**Urban collectives**	**Others**	**Total**
1985	3.32 (3.7%)	0.72 (2.2%)	0.05 (11.4%)	4.09 (3.3%)
1990	13.72 (13.3)	2.87 (8.1)	0.43 (26.3)	17.02 (12.1)
1995	43.96 (40.1)	11.49 (37.4)	5.51 (62.8)	60.96 (40.9)
1996	55.49 (50.7)	13.94 (47.2)	6.37 (67.6)	75.80 (51.1)
1997	55.57 (51.6)	14.24 (50.5)	7.27 (67.8)	77.08 (52.6)

Source: SSB, 1998: 150

From 1994 onward, most state-owned enterprises began to abolish the permanent worker system through converting all of the workforces onto a contract basis. Subsequently, the number of contract workers grew rapidly. By 1997, over half the industrial workers were on the contract system (see Table 2.5). The pace of labour contract implementation has clearly been much faster in the SSEZ and in non-state firms than in the state or collective sectors. In anticipating the potential employment insecurity implicit in the labour contract, cadres were able to utilize their previous positions to mitigate the potential risks of contract employment. One common method for risk aversion was to retain their permanent posts in state organs as safety valve, should the contract not be renewed in the joint venture (Howell, 1993).

It was hoped that the widespread implementation of contract system would add some flexibility to the employment relation, because contracts would not necessarily be renewed after five years. Obviously, some extent of flexibility in quits and fires could be achieved as a contract expired. Another, and related, purpose of introducing labour contract was to change the nature of the relationship linking state firms and workers in the category that had previously been labeled "permanent" (Naughton, 1995a: 210). The ultimate purpose was to create a 'level playing field' between state and non-state firms in the area of HRM.

2.2.2.2 The 1994 Labour Law

As labour contract systems further extended in the 1990s, the government enacted a new Labour Law in July 1994 that was effective on January 1, 1995. The law is intended "to

protect the legal interests of labour, regulate labour relations, establish and maintain a labour system compatible with a socialist market economy, and promote economic development and social progress based on the Constitution" (Clause 1). The new Labour Law contains the 13 chapters, and 107 detailed clauses. It comprehensively codifies legislation of all categories of enterprises, and covers employment rights, individual and collective contracts, redundancy, health and safety, dispute procedures, and arbitration (see Table 2.6.). The Labour Law "is applicable to all enterprises, individual economic organizations and workers involved in labour relations" (Clause 2).

Table 2.6. Main headings of the 1994 Labour Law: contents

1. Principles
2. Employment promotion
3. Labour contracts and collective contracts
4. Corking hours and holidays
5. Wages
6. Labour safety and hygiene
7. Protection of women and young workers
8. Vocational training
9. Social security and welfare
10. Labour disputes
11. Monitoring and inspection
12. Legal obligations
13. Supplementary

Source: the 1994 Labour Law, p.1. (Also see, Warner's Appendix 1,1995)

Under the Labour Law, the labour contract system is legally recognized as a formal employment system. It states clearly that: "A labour contract is an agreement which defines the employment relations between the employing unit and its workers and clarifies the rights and obligations of both parties" (Clause 16). It includes both individual labour contracts and collective contracts. A labour contract shall be made in written form and have the following items (Clause 19):

- Period of validity of the contract;
- Work content;
- Labour protection and conditions;
- Labour remuneration;
- Labour discipline;
- Conditions for the termination of the contract;
- Obligations for violating the contract

The length of a labour contract "can be fixed, unfixed or terminated at the completion of a certain task" (Clause 20). If "a worker has worked in the same employment unit continuously for over ten years and both the worker and the unit agree to renew the

contract, indefinite contracts shall be made if demanded by the worker" (Clause 20). "Probationary periods can be regulated in the contract, which cannot exceed six months at the longest" (Clause 21).

In a broad sense, the Labour Law has laid a legal foundation for governing labour relations between the employer and the employee. It attempts to protect all legal rights of workers, at the same time the Labour Law seeks to protect the enterprise' interests from the negative effects of increased labour turnover made possible through the contract system. For instance, workers who have received training from the enterprise but fail to work for the stipulated period afterwards are required to compensate the firm for the training costs according to the contract. However, there is clearly a potential contradiction in the Labour Law, on the one hand between a commitment to protect the interests of the workers and on the other the desire to strengthen the discretion of the enterprise over its workforce (Warner, 1997).

2.2.2.3 Linking wages and bonuses to profits

In parallel with introducing the labour contract system into the state sector, the government extended reform to a uniform nation wage setting system. First, state firms were permitted to use a bonus payment that was linked to the enterprise profits. The maximum of bonus payments in the firm, however, was restricted to the equivalent of the three-month employees' wages. In 1984, absolute ceilings on bonus payments were replaced by a progressive bonus tax. If aggregate bonuses were less than 2.5 months standard wage, there was no tax. Between 2.5 and 4 months, a 30 percent tax was imposed, and this increased to 100 per cent between 4 and 6 months and 300 per cent above 6 months (Jackson, 1992). Later on, enterprises were given the freedom to determine how the bonus fund would be combined with wages within the organization, including experiments with floating wages, and piece rates. In this way, the distinction between base wage and bonus was dissolved, and a link between enterprise productivity and the total wage bill established.

Frequently, individuals' bonuses were allocated on a more or less equal basis because of the strong egalitarian ethos. Egalitarian pressures had also limited the use of piece rates and other payment-by-results schemes. One study found that workers successfully resisted such schemes, because they led to harder work, increased competition, and little more pay on the average. As an alternative, top mangers withheld 20 to 30 percent of the basic wages and put the money into the bonus pool (Byrd and Tidrick, 1987: 74).

In the early 1980s, some SOEs had diverted retained profits from the production development fund to worker benefits. Other had regularly paid bonuses equal to more than four months of basic wages, even though the legal limit was about three months. After the imposition of a progressive bonus tax in 1984, many enterprises began to try to evade it by paying bonuses in kind or paying extra subsidies (Byrd and Tidrick, 1978: 63; Walder, 1989). When faced with administrative controls on cash disbursements, managers turned to distributions in kind through welfare funds, rapid construction of housing, and other strategies to distribute income to their workers (Walder 1989). If enterprises have full

autonomy to use profits as they wish, many of them would choose to distribute all profits as bonuses, or use up all profits in welfare payments. But there are explicit restrictions on the use of profits and limits on bonus and wage payments ensure that managers' act in the interest of the principal, i.e. the state (Byrd and Tidrick, 1987).

In the late 1994, the State Council issued a new wage guideline of *Two Lowers* applicable to SOEs (SESRO, 1997). The so-called *Two Lowers* was expressed as follows: 1) the scale of aggregate wage bill increase should be lower than the rate of profits, and 2) average employees' wages increase should be lower than the rage of labour productivity growth. In essence, there was an implicit dynamic linkage between wage growth and productivity. And a value of the elasticity of the linkage between the productivity indicator and the total wage bill was designed, with the elasticity generally set around 0.7[10]. From the late 1980s, the state froze the aggregate wage bill of enterprises for a few years. During the wage freeze period, enterprises could not increase the wage bill if additional workers were recruited. Similarly, enterprises cutting down on workforce would not lead to the reduction of total wage bills.

2.2.2.4 Wage determination within the enterprise

Starting in the late 1984, the government attempted to link the enterprise aggregate wage bill to its performance, using case-to-case predetermined elasticity of the linkage of productivity and the total wage bill. This led enterprise management to have the right to determine the internal wage compensation. The discretion over the internal wage compensation must, however, be conformed to the state wage policies in the 1980s. Most enterprises adopted, for instance, floating wage systems under which some former bonuses were reclassified as part of the base wage (Naughton, 1995a). In order to control the pace of wage growth, a wage tax was levied in 1986 on the percentage increase in the enterprise aggregate wage bill over the previous year. The purpose of introducing wage taxes was to mitigate overgrowth of wage compensation relative to profit growth[11]. Moreover, in order to enhance incentive compensation, managers were required to reclassify some part of the base wage as incentive pay.

From 1994 onward, the state ceased to set nation wide wage quotas and scales for different categories of workers periodically as was the case as before. Instead, a state wage guidance

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[10] The most common indicators were total tax and profit remitted to the government, but some enterprises were permitted to designate total profit, output or sales revenues as the productivity indicator. That is, if an enterprise's remitted tax and profit increased by 1 per cent compared with the previous year, its total wage bill was allowed to increase by 0.7 per cent. If profitability decreased by 1 per cent, the wage bill was expected to decrease by 0.7 per cent as well (Naughton, 1995a: 208).

[11] Under the linkage of the total wage bill to productivity and wage increase tax, an enterprise might choose to draw a sum of money authorized for wages from profits, but put it in a bank rather than actually paying it out, thereby avoiding taxes. This would be a kind of enterprise savings, available to be tapped for wages in a later year of slower growth (Naughton, 1995a: 208).

of the *Two Lowers* (see above) applied to SOEs. Within the state wage guidance, top enterprise managers enjoy complete autonomy over the forms and scales of rewarding employees based on performance, as long as preferred compensation practices stay in line with the elasticity of wage increase linkage to profits.

2.2.2.5 Laying off redundant workers

It is well known that China's SOEs are overstaffed in comparison with non-state firms. One study estimates that 20 per cent of state employees could be reduced without any impacts on output (Yang Yiyong, 1998). The widespread overmanning problem was unmasked in the 1990s as market competition became intense. As early as in 1988, state firms were encouraged to launch a "labour reoptimization" scheme to get rid of redundant workers, but failed to achieve the desired result (Warner, 1995). Beginning in 1995, and especially in 1997, the central government advocated more radical downsizing as a new labour reform policy in SOEs. Downsizing was detailed in 1998 by the Chinese Premier Zhu Rongji into three concrete steps: *laying off so as to divert redundant workers out*; *reducing workforce so as to increase efficiency*; *and implementing re-employment project within the enterprise*. In response, governments at the local level urge SOEs under their jurisdiction to implement the downsizing strategy.

Under the downsizing pressure, state enterprise managers are required to reassess manpower needs in each workshop and auxiliary activities. Redundant workers will be laid off for retraining, or declared them "in-house unemployed." Municipalities also need to establish labour retraining and unemployment funds to aid enterprises to transfer redundant workers to new occupations. In most cases, laid off workers would be put on reduced wages, though they were not fired in name (Naughton, 1995a). In order to maintain social stability and fear of unrest out of laying off, each enterprise engaging in downsizing of workers is required to set up the *reemployment center* in their organization to help laid off workers find a paid job elsewhere. Downsizing thus provides state managers with an opportunity to overhaul overstaffed employment.

2.2.2.6 Creating a social security net

China's pre-reform labour insurance system was based on the state-owned enterprise that took full responsibility for paying pensions, medical care, and other labour insurance benefits to their employees. The social security and welfare functions of enterprises resulted in extreme immobility of labour since workers were tied to one enterprise. It also made bankruptcy difficult to implement in large ailing SOEs. In particular, the lack of unified pension schemes and unemployment insurance poses great difficulty to enterprise management in attempts to adjust the workforce to market changes. Apparently, without transferring pensions, health, and education obligations from firms to government bodies, most state firms cannot become competitive players in markets.

As labour system reforms proceeded further in the early 1990s, creating a social security

net was advocated at local levels. The overall objective was to establish a range of social insurance funds contributed by three parties: the State, the enterprise, and the individual employee. In the beginning, the unemployment insurance fund was collected only for contract workers, who were considered of less job insecurity. The 1994 Labour Law further confirms the intention of setting up a national social insurance system. As required, all employers and employees, regardless of their ownership, need to join the reform and make contribution to five separate funds (i.e. pension, accident and injury, maternity, unemployment and, medical funds). Usually, local municipalities pool up pension obligations across firms, or earmark payroll taxes for pension, unemployment, and health insurance (World Bank, 1997). In practice, enterprises are required to deposit a sum from pretax profits equivalent to 15 per cent of the aggregate wage bill, while the individual worker should contribute 3 per cent of his wage to the five funds (Ding and Warner, 1999). Pooled social security funds were administered at the local county or municipality level (Naughton, 1995a). Currently, free medical care is becoming the thing of the past. State employees need to pay part of their medial expenses out of their pocket.

2.2.2.7 Housing reforms

Urban housing became another target of labour reform in SOEs in the late 1980s. In the past, state firms were obliged to provide housing to every permanent employee. The company had to build residential houses that were distributed as welfare benefits on either employees' seniority or their employment status (i.e., cadres or workers), although managerial cadres could use housing distribution to institute their privileges, to reward political loyalty, and to discipline workers (Zhou and Logan, 1996). Housing distribution thus helped to cement labour immobility and employment rigidity in SOEs.

In July 1994, the State Council issued "*The Decision on Deepening the Urban Housing Reform*". Housing, like other employment related welfare benefits, was exposed to marketization and privatization (Wang and Murie, 1996). According to the Decision, a state worker, who occupies a company house, is required to either buy out the house at quasi-market prices, or to return it back to the company when leaving the company. State firms hoped to relinquish their long-standing obligations of offering housing to new recruited workers, who need to buy or to rent on markets (Chen, 1996). Suspension of the welfare-based housing distribution was further pushed by the newly elected Primer Zhu Rongji in his inauguration addressing to the Ninth National Congress held in the spring 1998. Although that program was postponed afterwards due to the limited affordability of the majority workers, housing employees is out of the agenda of the enterprise managers.

In brief, reforming of the enterprise-based social security system is not easy, and the progress seems frustratingly slow. Despite this, the established social security systems provide some extent of security to workers facing unemployment. In particular, commercialization of housing can considerably diminish overdue burdens of state firms in recruiting new workers. It also adds flexibility to employment. As a result, the socially pooled pension and unemployment funds, separated from enterprises, create supporting social infrastructure that enable managers to adjust labour according to market changes.

2.2.2.8 Creating labour market institutions

As the contract employment system was spread, labour market institutions have emerged at local levels to deal with recruitment and selection for local companies. Among the emerged labour market institutions, Labour Service Corporations appeared since 1979 to facilitate the local recruitment of labour and the promotion of the collective and private individual sector (Howell, 1993). Another stride was made in the mid-1980s when the local Labour Bureau and Personnel Bureau established, respectively, *labour exchange center* and *personnel exchange center* to cater for correspondent segments of labour mobility at local labour markets. The two established human resource exchange enters are in line with the paralleled labour regime institutions, as indicated above. The labour exchange center was created to facilitate and promote employment for unskilled workers or new labour entrants with educational attainments below the college level. While the personnel exchange center is set up mainly for skilled workers and professional and technical staff who want to change their jobs, or new graduates from colleges and university.

By 1998, about 2500 talented personnel exchange centers across the country were established at most medium and large cities (Beijing Review, 1998c). These personnel exchange centers have fixed locations and facilities that assist speeding up the circulation of professionals and technical staff into market destinations (People's Daily, Nov. 10, 1999). In the words of the chief manager of the training department of Wuhan Talented Exchange Center, the personnel exchange center distinguishes itself from the labour exchange center in that the participants in the former are aimed to "*choose better bowls*" (namely, higher salaries, better promotion opportunities). In contrast, the participants in the latter are mainly intended to "*look for a bowl*" for survival (i.e. paid jobs). Hence, labour market institutions, which function as a brokerage or mediation, as observed in Western economies, are not fully present in China.

2.2.2.9 Establishing a labour reserve system

In anticipating heavy employment pressure from the new labour entrants, the government announced a "new labour reserve scheme" in 1997 to retard the pace of school graduates into labour markets. According to the recipe of this new employment scheme, some 21 million Chinese youngster, who graduate each year from secondary schools, and who fail to enter higher level education institutions, have to accept one to three years professional training before being offered a paid job (Beijing Review, 1997: 5). Subsequently, the Ministry of Labour chose 36 major cities to spearhead the experiment, which was applied full-scale in April 1998 (People's Daily, 1999).

2.2.3 Concluding remarks

Clearly, as the above labour reform measures play out, Chinese people are working in a

changed labour environment that is quite different from the one a few years ago (see Table 2.7).

First, by introducing the labour contract system into the state sector, the 'iron rice-bowl' employment system eventually comes to the end in SOEs. Second, the emergence of market-oriented recruitment and selection enables workers to freely choose a job in markets. It also grants management some freedom to hire and fire personnel from external markets. Third, the rise of various forms of incentive pay and bonuses creates a link, though weak, between bonus payments and performance. Under the link scheme, managers gain the formal authority to compensate the employees for their performance. Fourthly, the implementation of the Labour Law provides a legal framework for managing human resources in companies. The establishment of labour market institutions, although premature, creates a 'level playing field' for all types of firms to pursue a labour market approach to labour. As a result, labour management turns out to be a contractual relationship between the employee and the employer, with the latter assuming more power in determining the employment term of the former.

Table 2.7. Characteristics of Chinese industrial organization models

Old model	New model
Maoist strategy	Dengist strategy
State ownership	Diffused ownership
Resource-constrained	Market-driven
Technical criteria	Allocative efficiency
Taylorist work organization	Flexible work organization
Economic cadres	Professional managers
Iron rice-bowl	Labour market
Jobs for life	Employment contract
Work assignment	Job choice
Personnel administration	Human resource management
Egalitarian pay and perks	Performance-related rewards
Enterprise-based training	Outside courses
Company accommodation	Rented housing market
In-house social services	External social provision
Free medical care	Contributory medical insurance
Central trade union role	Weaken union influence
High institutional dependency	Low institutional dependency

Source: Based on Warner 1995, p. 50; 1999, p. 4.

Changes are most drastic in the state sector where state workers gradually lose their employment-related privilege and security. They are now exposed to labour market processes, like their counterparts in non-state firms. As enterprise-based social welfare benefits are increasingly shifted to the external agencies, a convergent employment condition is evolving between state and non-state firms. Eventually, the enterprises enjoy autonomy of decision making for most strategic issues (including personnel). As Naughton

(1995a: 212) notes, "China's labour system had modest amounts of flexibility. It was no longer the extraordinary rigid system of the 1970s. Indeed, an institutional framework had been put in place that was adequate to support significant change…" In particular, with the establishment of employment service institutions, enterprise managers can make a multiple choice in recruitment and selection. It is to be expected that labour flexibility and mobility would increase as labour management moves to market practices of mechanism.

2.3 Labour management in transition

As clearly shown in the preceding sections, the two-decade's economic reform has not dismantled the inherited industrial institutions, although some degree of deregulation and decentralization did occur between the institutions and related firms. Labour reform, which began in the mid-1980s, still lags behind other aspects of reforms due to the complicated employment system located in industrial institutions. Consequently, drastic changes have occurred as significantly as continuities in labour management institutions remain.

2.3.1 Changed industrial governance

Throughout the entire 1980s and up to the mid-1990s, China's industrial governance structure had two parallel hierarchies, that of administration and that of the Party (see Child, 1994: 21). Both hierarchies were 'inextricably linked', and shaped the management of state-owned enterprises. Enterprise management was located in a matrix of administrative lines in parallel with Party organs along the hierarchy line from the top (see Figure 2.2).

At the apex of the hierarchy are higher administration, i.e. the State Council, and the central Communist Party Committee. The former enacts important industrial policies and regulations governing enterprises, according to the Party's principle policy, formulated by the latter. At the bottom of the hierarchy are state enterprises, within which the party plays a formal role in promoting ideological awareness and to 'guarantee and supervise' the implementation of government and party policies. Although management autonomy was substantially increased relative to the Party secretary in the late 1980s, most managers are members of the party, and their political loyalty to the Party is an important factor for promotion.

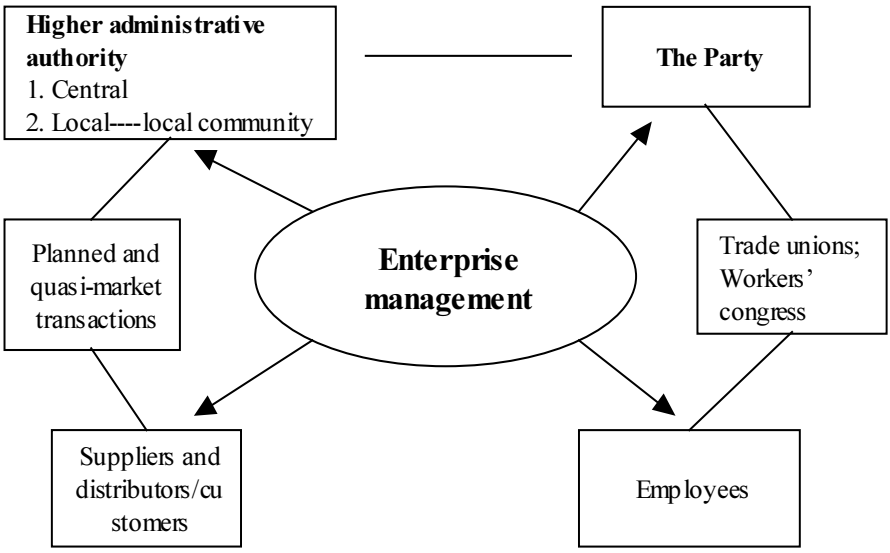

Figure 2.2. Location of Chinese enterprise management within a system of dependencies
Source: Child (1994: 26)

Chinese trade unions, as defined in the 1993 Trade Union Law, are 'mass organizations' of the working class under the leadership of the Party (Warner, 1995). Like the hierarchy of the Party, the All-China Federation of Trade Unions (ACFTU) is the only one recognized national organization at the top, consisting of fifteen different industry unions (Hong and Warner, 1998). Below the ACFTU are federations at provincial, municipal, and county levels. Unions have their branches extended down to enterprises, and provide the executive arm and secretariat for Workers' Congress (i.e. Workers and Staff Representative Congresses). They also represent workers to sign collective employment contracts with management, as required by the 1994 Labour Law (see later). Trade Unions have extremely high memberships of over 90 per cent of the country's total workforces in urban state enterprises (Hong and Warner, 1998). In non-state firms, the presence of trade union organizations is not mandatory but required, according to the Trade Union Law[12].

In the past, the Workers' Congress was described as a highest management authority body in state-owned enterprises, exercising democratic management (Littler and Lockett, 1983). Its role is now restricted to commenting on management decisions from the view of workers interests, and to be consulted on matters such as the proposed dismissal of an employee (Hong and Warner, 1998). Similarly, the prescribed roles of unions, according to

[12] Trade Union Law of the People's Republic of China was adopted at the Fifth Session of the Seventh National Peoples' Congress on April 3, 1992 and effective as of the same date. See Appendix I, in Warner (1995: 167).

the 1993 Trade Union Law, are to assist management in making a success of running the enterprises, and to safeguard the legitimate rights and interests of staff and workers. In practice, both the roles of unions and Workers' Congress are restricted to welfare areas of employees. They serve as a 'transmission belt' between management and employees. They are subordinate to the authority of the Party (Littler and Lockett, 1983).

The dominance of bureaucratic administration and the Party hierarchy put enterprise management under complex vertical dependencies (Child, 1994). In the 1980s, vertical relationship was manifested as resource dependency of state managers on external supervising agencies for the supply of necessary scarce resources for the fulfillment of quotas and targets. In the 1990s, such a type of resource dependence substantially diminished as market transaction steadily grew. In particular, a new governance structure has been created to govern corporatized state firms, where strategic decisions are now taken by the headquarters or the board, which replaced the government industrial bureaux as the managerial authority. As the enterprises are further exposed to market transactions, decision-making has become concentrated at the director and executive levels (Lu and Child, 1996).

However, the corporatization scheme widely implemented in the mid-1990s has brought two new forms of corporate governance to SOEs: limited liability companies (LLCs), and limited liability shareholding companies (LLSCs). Under the LLCs, three new pillars of power (i.e. *shareholders' congress, the board of directors, and the supervisory board*) have been set up, parallel with (not yet replacing) the three existing old internal power pillars in SOEs (i.e. trade unions, workers congress, and the Party committee). The newly created authority pillars overshadow the functions of the old ones as assumed in the traditional SOEs. In most cases, LLCs do not hold shareholders' meetings as assumed in the Company Law. Instead, the board of directors exercises most power otherwise represented by a meeting of shareholders. Moreover, the board of supervisors, which usually consists of representatives from the enterprise's official supervisory departments, state banks, experts, managers, and invited workers, cannot effectively exercise its supervisory authority over management. Top managers, under the supervision of the board of directors can benefit from significant job-related prerequisites, such as expense allowances for entertainment, transportation, and housing, as well as other economic rents (World Bank, 1997). Although corporatized SOE managers have no legal recognition of property rights, they have de-facto rights to use and dispose of state assets and to enjoy incomes so generated.

It should be noted that, despite the increased autonomy of the general manager in the enterprise, the Party never relinquished its control over personnel. In particular, state managers are mostly party members, and subject to party discipline. Their political loyalty is still a necessary requirement for their promotion. All the important matters, especially those associated with appointment, and incentives, were generally decided within the enterprise party committee, of which the general manager and other senior managers are normally members. Child (1994) notes that much of personnel decisions depend on the internal power structure as well as the relative influence enjoyed by persons concerned. He points out there is a 'game of power' (Child, 1994: 161) between the Party secretary and the general manager in control of personnel in SOEs.

In addition, external supervising authorities continue to control senior managers through appointment. And they can also significantly influence the allocation of managers' rewards. Hence, state managers are still responsible to the authorities for meeting agreed profit and investment targets, and for contributing tax revenues from profits.

2.3.2 Labour regime in transition

Under the changed industrial governance lies labour regime. China's labour regime, modeled on the former Soviet Union in the 1950s (Warner, 1995), evolved along the hierarchy of industrial governance institutions. It is a highly regulated labour regime under which the dogma of the *'Party managing cadres'* dictates personnel management top-down at all levels of the state sector (Child, 1994). At the top, there are two Ministries under the leadership of the central government bureaucracy: *Ministry of Labour* (now the Ministry of Labour and Social Security from 1998 onward) and *Ministry of Personnel*. The two-decade reform has not changed these paralleled institutions. The two Ministries are responsible, respectively, for formulating labour and personnel policy guidelines. Such policy guidelines are then further detailed by the two subordinate organizations at the provincial level (see Table 2.8). Key policy elements include labour recruitment procedures and selection, personnel appointments and appraisal, professional standards, wage policy and bonus payment, and on-the-job training (HLB, 1997a, 1997b).

Table 2.8. Hierarchy of labour management regime in China

State level	**Ministry of Labour**	**Ministry of Personnel**
	• Wage policy	• Salary policy
	• Safety policy	• Promotion criteria
	• Skill scales	• Professional assessment
Provincial level	Bureau of Labour	Bureau of Personnel
	• Complementary labour regulations	• Appointment of high management personnel
	• Social security fund	• Performance evaluation
Enterprise level	Labour management	Personnel management
	• Production workers	• Managerial, and administrative staff
	• Migrant workers	• Technicians
	• Temporary workers	• University new graduates

Source: with reference to HLB, 1997a, 1997b.

At the enterprise level, two corresponding human resource systems coexist. They are *labour management* and *personnel management,* each has its own entry port and career ladders. The former covers manual workers whose jobs are closely related to physical activities. The latter covers managers, technicians, political staff, office and clerical employees (Child, 1994; Warner, 1995). The entry into either of these two systems is

determined by someone's educational attainment. According to the 1985 Personnel System and Administrative Regulation, anyone who graduated from colleges and above would automatically acquires a *cadre* status and fall into the personnel management system when employed in the state sector. Whereas persons graduated from technical schools and vocational schools and below can only be employed as a *worker* and fall in the labour management system of the state sector. Being a cadre under the personnel management system, one can enjoy a higher privilege over a worker in terms of a wage raise, housing, promotion, health care, and on-the-job training (Lu and Child, 1996). For instance, regular workers under the labour system were put on eight wage grades, whole cadres, technicians, and engineers under the personnel system were subject to seventeen salary grades. Usually, the salary scale in the latter case is higher than the wage scale in the former (Child, 1994; Warner, 1995).

The two parallel HR systems resulted in internal segmentation between workers and cadres in the same organization. The segmentation was mainly grounded on but not necessarily confined to the combination of someone's educational achievement, Party membership, and performance (Chen, 1995). Change in employment status from a worker to a cadre was only possible when one outperformed others in production or in political attitudes to the Party. This seemingly occupation-based segmentation was derived essentially from someone's employment status determined at the beginning of his or her entry. Such segmentation remained unchanged until the mid-1990s. As indicated above, the recent labour reforms have to a great extent blurred the demarcation line between workers and cadres, permitting star workers to do office jobs. In comparison with *labour management*, there has been little change in the *personnel management* system (Child, 1994).

Nevertheless, although many efforts have been made toward the personnel area, the pace of labour market-led reform has proved frustratingly slowly. Not only is such reform a culturally and politically sensitive area of management, but also the consequence of the reform that has incurred massive layoffs and increased unemployment poses a great challenge to the government and leads traumas to workers. For the government, by pursuing labour market practices this marks a retreat from its past long-lasting commitment to the full employment policy guaranteed to all able workers. This perilous break-up from the orthodox ideology thus stirs up a political debate on the nature of labour, namely, the status of workers, in the socialist country that might further undermine government legitimacy (Warner, 1995). For ordinary workers, by introducing labour market policies into the enterprise it implies employment insecurity that threatens their stable jobs and incomes. It is not surprising that a strong resistance to change arose when workers lost their jobs for the first time in their live (Cheng, 1989). The resistance is most potent in SOEs, whose employees are most likely adversely affected and "whose major stakeholders are not always supportive of (and are sometimes outright hostile to) such reforms" (Shenkar, 1991: 1). Even in some foreign joint ventures with SOEs as local partners, dismissal of employees is widely reported as the most difficult issue confronting foreign managers (Child, 1994).

In short, despite continuities remaining in China's labour-management regime, two-decade of economic reforms has brought about dramatic changes in labour management in companies. Two common dilemmas will continue to plague Chinese managers in their

daily management. In the first place, the industrial enterprise is under increasing pressure to focus on core business, yet management cannot withdraw immediately from multiple commitments to the employees. Second, managers are expected to assume autonomy over the enterprise, but internal authority structures and external constraints on personnel decisions strongly impede them to take full responsibility (Child, 1990; 1994; Shenkar, 1996). Hence, it is reasonable to anticipate that Chinese managers, despite acquiring great authority, have to cope with remaining institutional constraints.

2.4 Market disciplines and the remaining constraints in labour management

The preceding sections clearly show that the two-decade market-oriented reform has largely converted Chinese enterprises into an individual business decision-making entity, although in many areas of daily management constraints remain. The following section pinpoints some market disciplines and constraints that enterprise managers have to deal with in their daily management.

2.4.1 Market disciplines

Currently, all industrial companies are increasingly subjected to market disciplines as the result of the rising market competition. At least, three types of market disciplines are most influential to firms operating in China's transition context. These are *capital market discipline*, *internal discipline*, *labour-market discipline*, and *product-market discipline* (see McMillan, 1995).

Briefly, *capital market discipline* arose, although weakly, from the 1990s banking and fiscal reforms that tightened budget constraints on SOEs. In particular, the creation of two stock exchanges in Shanghai and Shenzhen in the early 1990s, and the ensuing corporatization of state-owned firms, introduced corporate control to eliminate 'insider control' problems inherent in the 1980s increased management autonomy (World Bank, 1997). Meanwhile, some extent of *internal discipline* emerges in both state and non-state firms. State firm managers' pay is, for instance, linked to their firms' performance, measured by profits and sales. Their career promotion and demotion by industrial bureaus depend on performance of their firms up to potential[13] (Naughton and McMillan, 1994).

Another market discipline comes from *product market* where both state and non-sate firms need to compete for survival and continued operations. In the past, most Chinese managers could simply pursue their own motives through expansion when there was a seller's market, or when profits were high (Byrd and Tidrick, 1987). However, as markets shifted to a buyer's one in the 1990s which threatens the firm's profit margin, the manager could not indulge in the expansion motive any more as the result of investment reforms. The

[13] In most cases, top managers under the CMRS were required to post a bond, which can be forfeited if the firm under-performs (McMillan and Naughton, 1996).

growing presence of multinationals in China in the 1990s further intensified product market competition. Consequently, state and non-state firms had to compete for buying inputs, as well as for selling products. In other words, market competition forces enterprise management need to be more concerned with sales and profits if they are to survive.

Most effective market discipline arises from distinctive characteristics of China's *labour market* where excess unskilled labour co-exists with relative scarcity of skilled labour in supply. For unskilled labour which is in almost infinite supply, managers and firms need to find ways to flexibly utilize it as cost effectively as possible, using market practices, time contracts, and differentiated wage rates. For skilled labour which is relatively scarce in labour markets, the management needs to find effective ways of keeping smart employees by offering them promising career development, training, promotion, tenure, bonus, and stock options for a long-term commitment. Strategically taking use of these two different labour market segments for higher labour flexibility will have significant impacts on the firm's competitiveness and success in product markets, which requires the firm's management to have strategic visions on daily HRM activities in the organization (Goodall and Warner, 1997; Warner, 1995).

As more autonomy is delegated to the enterprise management, managers are under great pressures to take full responsibility for the loss and profit of enterprise operations. In other words, managers have to think strategically, to be business oriented rather than production oriented, to take greater risks, and to be more entrepreneurial. These positive changes will inevitably reshape HRM practices /labour relations in companies.

2.4.2 Remaining constraints

On the other hand, the existing institutional influence, coupled with the continuing interventions of governmental bureaux and the party organization in enterprises, poses constraints on management in the area of labour and personnel management (Child 1994, Shenkar, 1991). The following three constraints are most commonly pronounced in SOEs, to less extent in non-state firms.

Compliance. Chinese state managers have a strong tendency of compliance to their supervising agencies. The compliance motive essentially stems from the management appointment practices applicable mainly to most corporatized SOEs. To some extent, the motive to comply with the directives of superiors can be attributed to managers' desire to be a good bureaucratic citizen rather than to produce a superior product and gain peer approval (Byrd and Tidrick, 1987). It was reported in the 1980s that most state managers were caught between conflicting demands of multi-headed leadership (Lockett, 1983, 1988). Although management discretion has increased substantially with the implementation of corporatization in the 1990s, managers still need to positively respond to general policy directives from the party and the superior agencies that appoint them. Denial, or defy of superiors' directives may bring managers' career prospects in jeopardy, either in a management profession or in a bureaucratic hierarchy.

Even in non-state firms, the compliance with the directives of immediate superiors is also

of paramount importance. Because the establishment of a private firm not only requires the site, land, and license, but also needs good relations with local supervising agencies. Access to these requirements is controlled in the hands of local officials. Often, private firms are most likely vulnerable to bureaucratic delay or predatory charges that can easily block, even kill the new birth of private establishments, unless they are big enough as main tax revenue contributors.

Policy constraint. To date, state-owned firms are obliged to comply with more strict government industrial policies than non-state firms. For instance, state firms need to follow the state wage guidance, which is not applicable to non-state firms. On the political side, state managers are required to be accountable to party officials and committees for ideologically acceptable conducts. As part of the state sector, state-owned firms were asked to pioneer five working days per week a half year earlier than non-state firms in 1996, as required by the government. On the other hand, state firms may enjoy certain protections from the local governments. These can be ranged from a priority of getting state banks' credit loan, to fiscal assistance, and subsidies once falling in financial difficulties. Moreover, state firms often operate under the condition of soft budget constraints to which non-state firms are not accessible.

Labour constraint. As indicated above, China's labour market is characterized by excess unskilled labour and scarce skilled labour in supply relative to demand. And such a labour market condition will not change in the near future. These two distinct but related labour market segments impose significant constraints on the firm's management in flexibly using labour for both cost effectiveness and value addition. Although the 1990s labour reform has led to greater management discretion over labour, state managers have to rely on co-operation from workers for the fulfillment of economic goals (Child, 1994). Some skilled workers are apparently in a strong position to withhold such co-operation. Management has to invent or revamp HR systems for different categories of labour (Warner, 1995). However, state workers tend to hold more expectations than the firm can afford for a decent pay, housing, welfare provision, and employment security due to recently hardening budget constraints in SOEs. High labour turnover or low job commitment is most likely to arise if workers are not sufficiently rewarded or motivated for their performance under labour contract system. In addition, workers can readily voice their dissatisfaction through the workers' congress or trade unions and in this way bring further pressure to bear upon management (Child, 1994). It is clear that management may confront more labour constraints that take on facets different from the past.

2.5 Concluding remarks

Briefly, industrial firms in today's China are operating in a changed business environment while facing constraints. Firms and managers have acquired the increasing autonomy over daily operations, and are responsible for profits and losses of the organization. As a result, the role of labour, as well as the way in which the labour is flexibly utilized, has become an important factor in determining the firm's competitiveness, and therefore success, in competitive product markets.

Although the increasing market pressure forces the firm's management to be more market oriented, the business environment is still characterized by a set of dynamic interdependent relationships between the enterprise and its external supervising agencies. The dominant dependency is that of the enterprise upon its higher supervising authorities, although there are other countervailing relationships (e.g. increasing management autonomy) evolving on the horizontal level. Such mutual dependencies and dynamic processes may render managerial strategic choice and actions in the area of HRM hard to occur even if the management is delegated with responsibility for profits and losses of the firm. However, there are some loopholes left in the changing institution framework from where economic actors (e.g. managers) and their agencies can seek the best of their own interests.

Chapter Three

Labour Flexibility and Consistency of HR Systems: Toward an Analytical Framework

The essence of flexibility is to best use of the skills of labour force and put them in more fluid forms of work organization. --- Daniele Meulders and Luc Wilkin (1987)

Introduction

The preceding chapter described the extent to which the two-decade market-oriented reforms have impinged on labour management in Chinese manufacturing enterprises. This chapter intends to formulate an analytical framework to guide an empirical study of how the management seeks to increase labour flexibility in China's transition context. In the first section, the background of labour flexibility is briefly discussed in a Western context. Conceptual issues of labour flexibility are then reviewed as related to the firm's HR system. In the third section, three relevant theoretical perspectives on labour flexibility are presented, and their applicability to China's context discussed. In the end, an analytical framework is proposed to guide ensuing empirical analyses throughout the book.

3.1 Labour flexibility: A literature review

The concept of labour flexibility appeared in advanced industrial economies in the early 1980s when socio-economic, political and legal conditions were conducive to management regarding labour (OECD, 1986; 1989; Blyton and Morris, 1992). There were several factors that contributed to the prevalence of flexibility in Western economies. They included, intensified international competition, volatile and less predictable product markets (Volberda, 1998), advance in new technology, that in many cases undermined the logic of different job boundaries and job classifications (Blyton and Turnbull, 1998:326-328), the effect of different labour market conditions and government labour policy changes in favor of management (Osterman, 1989; Pfeffer, 1994).

A fundamental problem with labour flexibility lies in the fact that 'labour will not keep', i.e. cannot be held a stock of labour (Buitendam, 2001). Rather, labour has attributes principally different from other commodities such as raw materials, capital, etc. Labour is

a 'special type of commodity' (Buitendam, 2001; Solow, 1990). The implications for the management of labour are that organizations should be able to vary the size and composition of their workforces in tune with changes in market, technology, and competition. The resultant demand for labour flexibility represents a managerial response to the economic, technological and socio-political changes that put a premium on greater flexible manpower utilization in companies (Burack, et al, 1994).

More broadly, the rise of labour flexibility is indicative of departure from the Fordist towards a post- (or neo-) Fordist paradigm (Blyton and Morris, 1991; Reed, 1991; Kundsen and Boggs, 1996). In the 1950s and 1960s, *efficiency* was the most important criterion for success of the organization in a seller's market. In the 1970s, *quality* became another important criterion, in addition to efficiency as customers became more quality-oriented (Volberda, 1998). From the 1980s and up to now, *flexibility* has been added to efficiency and quality as a new way to achieve competitive advantage. As Morgan (1986: 35) states: "Changing circumstances call for different kinds of action and response. *Flexibility and capacities* for creative action thus become more important than narrow efficiency."

The central attributes of post-Fordism are flexible production, small batch production, labor contingency, and vertical disintegration (Blyton and Morris, 1991; 1992). These attributes enable the firm to earn its competitive edge under an uncertain and risky business environment (Bosworth, 1996). The driving forces behind the move to post-Fordism are growingly differentiated consumer demand, shortened product cycle, and quickened technological change (Malechi, 1996). Only the flexible firm is able to "…meet the twin goals of product innovation and quality" (ibid, 20). Therefore, flexibility is arguably becoming *a means* of the organization to meet a fundamental new strategic challenge.

The competitiveness of a flexible firm lies mainly in innovative product supply, niche market responsiveness, and external economies of scope, rather than pure price-effectiveness, standardized mass market services, and internal economies of scale (Volberda 1998). The flexible firm competes along dimensions that not only include traditional Fordist concerns such as economies of scale or price, but on quality, degree of customization, and timeliness of delivery as well. The introduction of new 'flexible manufacturing' techniques based on sophisticated computer-controlled machine tools have increased the ability of firms to respond to the very particular and frequently changing demands of niche markets (Kenney and Curry, 1996). In particular, new information technology has allowed the integration and coordination of activities both within and across firms (Bosworth, 1996). The growing demand in the West for the quality of working life facilitates the introduction of labour flexibility into work organization since flexibility can improve the quality of working life by giving participants more tasks, authority, and responsibilities (OECD, 1999).

Flexible firms need skilled and flexible workers. Workers must be sufficiently educated and trained to perform multi-skill jobs on an ever-changing mix of customized products. Technological change also raises the required level of both the analytical and the behavioral skills necessary to perform a job. This means that flexibilization of non-routine

work demands for the multi-dimensional and multi-talented workforce. Moreover, organization of work has to change accordingly. The increased horizontal authority of existing manager and worker empowerment are two of the more visible aspects of this alteration, giving rise to dramatic reductions in both the number of production workers and the number of middle level managers. They have also led to an increasing contingency of the labour force as firms seek to gain increased flexibility by altering the number of workers or working time, the wage of those workers, or the tasks that workers perform (Kundsen and Boggs, 1996: 9).

Apparently, the changed context of capitalist competition has altered the use of technology, labor, the way in which firms are organized internally, and the way in which they interact with each other. With increasing market competitive pressures, management has to prompt its market responsiveness, and the firm has to bring a new dynamic force into its sustained competitive strategy. Flexibility has thus become the employer's new frontier in the management of labour (Baglioni, 1990).

3.2 Conceptual issues: labour flexibility and consistency of HR systems

Although flexibility has become a new frontier of managing work and employment in Western firms, a commonly accepted concept of flexibility with a sound theoretical foundation has evolved (Blyton and Morris, 1992; Legge, 1995). For details about theoretical debates over flexibility, interested readers can refer to the 'regulation theory' (Aglietta, 1979), the 'flexible specialization' (Piore and Sabel, 1984), and the 'flexible firm' model (Atkinson, 1984, Atkinson and Meager, 1986). The following section is intended to find out how labour flexibility can be defined as related to the consistency perspective on the firm's HR system. The purpose is to develop analytical tools for analyzing labour flexibility in China.

3.2.1 Flexibility: concept, types, and forms

Flexibility can be defined in very different ways and at a different level. Put simply, flexibility stands to opposite rigidity, and it represents 'the ability to change or react with little penalty in time, effort, cost or performance' (Upton, 1994). More complex, flexibility can be viewed as *the autonomy and freedom* of action of the social partners in relation to each other; or the ability to place the burden of the cost of the necessary adjustments on the shoulders of other partners (Meulders and Wilkin, 1987). Volberda (1998) distinguishes flexibility between *operational, structural,* and *strategic* levels, each representing a combination of a variety of managerial capacities and speed of response. ***Strategic flexibility*** refers to managerial capabilities to alter the nature and direction of organizational activities in the face of non-routine challenges. ***Structural flexibility*** refers to 'managerial capabilities for adapting the organisational structure', and its decision-making process to 'changing conditions in an evolutionary way'. ***Operational flexibility*** refers to the capability to change 'volume and mix of activities rather than the kinds of activities undertaken within the firm' (Volberda 1998: 117-119). Here, flexibility is seen as

a *strategic asset* of the organization that can be built in terms of flexible resource, managerial capabilities, and broad strategic schemes on the synergy of three integrated levels. It is implied that without operational flexibility, structural flexibility can hardly be created, and strategic flexibility unviable.

Labour flexibility should be seen as a key component of the firm's total flexibility at the operational level. It can be defined as the 'ability of management to vary the use of labour (in terms of volume, qualifications and working time) in a company to fluctuations and changes in levels and patterns of demand' (Blyton & Morris, 1992). Often, two dimensions of labour flexibility can be distinguished. One common distinction is made between numerical flexibility and functional flexibility (OECD, 1986). *Numerical flexibility* refers to the ability of management to vary the quantity or volume of labour (i.e. the size of employment and the volume of working time). *Functional flexibility* refers to the ability of management to vary the functions of labour, i.e. having the workforce that is able to carry out a wide range of tasks.

Another distinction can be added to labour flexibility along the internal and external dimension. *Internal flexibility* is the *internalization* of environmental variation, for instance, as the volume of employment and the wage bill remains constant, conditions of adaptation are sought at the level of undertaking (Meulders and Wilkin, 1987: 6). *External flexibility* is the *externalization* of tasks that "are strategically unimportant and only loosely connected to the other tasks of the firm" (Baron and Kreps, 1999: 460).

By relating these two dimensions to each other, leads to four different combinations of labour flexibility practices (Steenbakker, 1994) (see Table 3.1). They are internal numerical flexibility, internal functional flexibility, external numerical flexibility, and external functional flexibility. Each type takes different forms of flexibility.

Table 3.1. Forms of labour flexibility

	Numerical	**Functional**
Internal	• Overtime work • Variable working time • Part-time jobs • Shift working • Flexible retirement schemes	• Job rotation • Work across functional dept. • Work in multi-tasks • Work in multi-sites .
External	• Temporary labour via external agencies • Short term contracts • Flexible contracts • Labour on call • Labour pool	• Contract out to specialist firms • Consultancy

Source: Steenbakkers, 1994

Each type of labour flexibility has different advantages and disadvantages to both the enterprise and the workers. Internal (numerical and functional) labour flexibility can bring

benefits to the existing workforce in terms of job security, but it may have adverse effects on working conditions (in the case of internal numerical flexibility) and workload or stress (in the case of internal functional flexibility). In contrast, external (numerical and functional) labour flexibility may have negative impacts on job security, while it offers a temporary employment opportunity for people who have otherwise no chance to access core employment status in the company on flexible conditions (i.e. external numerical flexibility), or for people with specific competence (external functional flexibility).

For the enterprise, external (numerical and functional) labour flexibility enables management to adjust employment size and composition to fluctuations in the demands for work. But some disadvantages arise in terms of quality (in the case of external numerical flexibility) and dependency on external knowledge (in the case of external functional flexibility). Conversely, internal (numerical and functional) labour flexibility will be achieved at the high cost of employees' effort losses and commitment to the company when change in the internal organization is required. But it might offer more security to the decreasing size of core employees in return for quality and commitment (internal numerical flexibility) and the preservation of firm-specific knowledge (internal functional flexibility) (Looise, De Lange, and Van Riemsdijk, 1997). The most extreme form of numerical flexibility is when the firm engages in downsizing that involves a large scale of layoffs for workforce reduction (Cameron, 1994).

Essentially, *Internal functional flexibility* concerns the versatility of employees to work within and between jobs. This can involve either vertical integration of tasks (performing tasks formerly carried out by other workers at higher levels) or horizontal integration (tasks formerly undertaken by others at a similar level). *Internal **n**umerical flexibility* concerns the ability of management to vary the amount of labour at short notice. This can be done internally by modifying working time patterns (i.e. use of shift working and overtime) to work pressure**.** Increasingly, outsourcing of personnel without employment bandage is attempted for flexibility in western firms, not only for minimizing transaction costs (Williamson, 1987; 1993), but also for exploring expertise to enhance functional flexibility that is in possession of outside specialist organizations (Baron and Kreps, 1999). Similarly, numerical flexibility is externally sought in Western firms by the use either of temporary and short-term contract workers or distancing through subcontracting as a means of responding to fluctuations in demand (Stark, 1995; Standing, 1989). Eventually, organizations may achieve some degree of financial flexibility, which indicates the move away from single payment systems, towards more various, variable and individualized systems, which seek among other things a closer linkage of rewards and individual performance (Blyton and Morris, 1992; Pfeffer, 1994).

In short, flexibility has an intuitive appeal, especially to management. Greater flexibility in this sense means that there are fewer legislated or negotiated constraints on layoffs, mass dismissals or hiring, as implied in numerical flexibility. It also means that management can 'adjust' the size and composition of its workforce more quickly in response to changing external and internal conditions (Laflamme et al, 1989). A second common use of the term refers to functional flexibility as expressed out as job enlargement and enrichment, and less bothersome work rules (Legge, 1995). Thirdly, flexibility in compensation refers to a range of measures, such as profit-sharing, performance-related bonuses, two-tiered wage

systems, and employees ownership schemes that allow management to link rewards and individual efforts more closely (Blyton and Turnbull, 1992). In some companies, wage flexibility means wage concessions that take the form of wage freezes, or wage reductions. These effectively become the alternatives to job loss and massive layoffs (Laflamme, 1989). In the end, flexible utilization of labour is euphemism of the intensification of work effort, with as much concerned over cutting down pauses and waiting time as over increasing the pace of work (Elger, 1991).

3.2.2 Consistency of HR systems

Osterman (1994b) argues that, for labour flexibility to fully play out at the workplace, a supporting HR system must be in place at the firm level. The importance of the firm's HR system is rooted in the human resource management approach that rose to prominence in Western management circles in later 1980s (Blyton and Trunbull, 1992; Storey, 1987; 1989). Distinguished from the traditional personnel management, HRM "seeks to achieve competitive advantage through the strategic deployment of a highly committed and capable workforce, using an integrated array of cultural, structural and personnel techniques (Storey, 1995: 5)". The essence of HRM lies in the integration of personnel management and corporate strategy that can be further traced to the resource-based theory of the firm (see, e.g. Barney, 1991; Lado and Wilson, 1994; Kamoche, 1996; Paauwe, 1996). The central argument of this perspective is that the sustained competitive advantage derives from a firm's internal resources. Human resources, in light of HRM postulates, when carefully selected, well nurtured and trained, and strategically deployed, can become a source of the company's sustained competitive advantage (Storey, 1995).

The firm's HR system is usually made up of policies and practices that function to facilitate management in the attainment of strategic goals of the organization (Miles and Snow, 1984). One of the key HR system functions is to attract highly qualified and motivated human resources into the organization, and to prevent their damage potentials from occurring (Muihlau, 2000). The firm's human resources as a source of competitive advantage can be tapped most effectively by mutually consistent policies that promote commitment and which, as a consequence, foster a willingness in employees to act flexibly in the interest of the "adaptive organization's pursuit of excellence" (Legge, 1989; Pfeffer, 1994).

In the HRM literature, there are two meanings of 'integration' inherent in consistency of the firm's HR system: *external* fit or integration with business strategy and, *internal* fit or consistency of employment policies and practices aimed at generating employee commitment, flexibility and quality. *External* fit with strategy largely relies on a contingent design of HR policies and practices, which in turn depends on *internal fit* (i.e. internal consistency of HR practices and policies). Baron and Kreps (1999) further advance the internal fit into three types of consistency: *single-employee* consistency, *among-employee* consistency, and *temporary consistency*. The single-employee consistency emphasizes "the different pieces of HR policy that bear on a single employee should be consistent with one another" (p.39). Among-employee consistency refers to the treatment of different workers that should at least over some span be consistent. Temporal

consistency concerns the degree of continuity of the HRM philosophy and premises as the organization evolves through time. Consistency among the elements of an organization's HR system is deemed necessary because of technological complementarities, social comparison, and organizational inertia (Baron and Kreps, 1999: 40-41). Obviously, a potential tension would arise if the assumed 'fit' or consistent HR system fails to achieve from the workforce when management attempts to increase labour flexibility in the organization.

Underlying the link of consistency of HR systems and flexibility is a close connection between business strategies and personnel policies and practices as assumed in HRM. As the firm operates in a market environment characterized by increased competition and greater turbulence, a key requirement of managerial strategic choice is to achieve both cost effectiveness and adaptability. "One way of matching this is the pursuit of greater workforce flexibility, in which the labour force is utilized more effectively, not least through being more responsive to fluctuations and shifts in both the nature and levels of demand, and changes in technology and production processes" (Blyton and Morris, 1992: 117). Guest (1987, 1989) points out that consistency among employees is one of four central goals of HRM policies (the other three being the integration of human resource issues into strategic plans, high commitment and high quality) to promote 'new patterns of working' with various forms of flexibility (Storey, 1989: 3). Osterman (1994b), after examining a set of flexible workplace practices adopted in American companies, concludes that a mix of consistent HR practices is necessary for the successful implementation of flexible work organization. Hence, certain consistency in the firm's HR system must be maintained to elicit flexibility from the workforce.

3.2.3 Discussion and evaluation

The above shows that the potential for labour flexibility would be considerably undermined if the required consistent HR policies and practices on the employees were lacking at the firm level. This can be illustrated from a strategic perspective on employment, as well as from empirical studies. Locke et al (1995) point out that labour flexibility, when sought along the numerical and functional dimensions, represents two contrasting employment strategies: *cost-based*, and *value-added*. The numerical flexibility is *cost-based* employment strategy, which focuses on reducing and flexibilizing labour costs. The main means to the end is to relax employment contracts through the segmentation of the workforce within the firm and the creation of atypical and precarious job categories (Atkinson, 1984). Examples of these practices are part-time work, contracting out, freelance or temporary employment, early retirement, as well as two-tier wage scales that work to the disadvantage of new employees.

In contrast, functional flexibility is *value-added* strategy, which emphasizes productivity improvements resulting from change in work organization such as teamwork, multi-tasks and job rotation (Blyton and Morris, 1992; Legge, 1995). It implies that; "flexible organizations together with flexible job content and flexible employees will result in a capacity to respond swiftly and effectively to changes and ensure the continuing high utilization of human and other resources" (Guest, 1987: 515). Corporate culture is

expected to be a fabric in forging a close linkage of individuals' ambitions to goals of the employing organization (Storey, 1995).

The two contrasting employment strategies could coexist in the same organization in spite of conflicting philosophies and the strikingly different practices each strategy contains with regard to labour. To implement two flexibility strategies simultaneously within the same company, the segmentation of the workforce between a 'core group' and 'peripheral groups' is usually involved (Atkinson, 1984; Atkinson and Meager, 1986).

Usually, the core workers are expected to deliver functional flexibility by virtue of training, retraining and redeployment across functional tasks, while peripheral workers supply numerical flexibility through varying working hours, constant hiring and firing. This means that the firm's workforce is deliberately segmented between a 'core' of a long-term employment and a 'periphery' of workers in a less continuous employment relationship. These two employment strategies also signal two distinct responsive strategies: reactively (or defensively) or proactively (offensively) (Miles and Snow, 1978), contingent on transaction costs of the alternative forms, as well as on constraints and opportunities that management encounters in negotiating the organization's environment (Child, 1997).

In most cases, companies tend to adopt both 'cost-based' and 'value-added' strategies, sometimes simultaneously, but more often one after the other (Locke et al, 1995). Management normally takes account of the both forms of flexibility simultaneously and chooses an optimal mix, given the structure of labor costs, other internal and external constraints, and corporate objectives such as profit maximization. Thus, there exists a trade-off between the two types of labor flexibility, and precise combination of the two is governed by a host of factors, such as unique configurations of cost structure, production functions, internal and external constraints, and management styles (OECD, 1986).

Various sources of empirical research on flexibility suggest that some increase in the use of numerical flexibility (mainly through rises in par-time working and subcontracting) is undertaken pragmatically and opportunistically, rather than as part of a coherent strategy in the flexible firm of ideal type (Legge, 1995). Similarly, functional flexibility is a modest and incremental change towards job enlargement and overlapping job descriptions and functions, but with little multi-skilling (Wielers and van de Meer, 1997). Despite a fairly widespread movement towards enhanced task flexibility, the degree of flexibility both sought for and achieved in most firms appears more modest than the theory assumes. In addition, functional flexibility appears to be largely determined by managerial juggling of technical, organizational and training cost considerations. At best, it is reflecting managerial awareness of the continuing advantages of retaining specialist skills in the firm. As Storey (1992: 91) notes that: "management may expressly want a limited number of experienced workers to remain dedicated to a particular task…Similarly, the costs of achieving flexibility - whether incurred through training or through extra payment for skill attainment - may also deter".

The extent of the flexibility sought and achieved in manufacturing firms depends in part on the combination of prior technological choices, production regimes, span of control, and

labour costs (Woodward, 1958, 1965; Ten Have, 1993). According to Woodward (1958), *the unit and small batch production* consists of all manufacturing technologies that need smaller spans of control, fewer levels of management. The individual employee's work varies depending on the stage of the production process through which the material is passing. *Large batch or mass production* produces great quantities of identical products using highly routinized, usually mechanized technologies that allow large spans of control and centralized decision making. Individual employees are required to perform only small part of work along highly mechanized assembly lines. *Continuous process production* involves a series of non-discrete transformations occurring in a sequence. The utilized processing technologies require smaller spans of control and decentralized decision-making, but more levels of management than either small batch or mass production technologies. If the majority of work is standardized and deskilled the implied necessity for task enrichment will prove to be somewhat illusory (Legge, 1995).

Similarly, the requirements for multi-skilled workforce implied in functional flexibility depend on technological investment and sophistication. Usually, routine technologies involve low task variability and high task analyzability, whereas non-routine technologies are characterized by high task variability and low task analyzability (Perrow, 1967). Task variability is defined by the number of exceptions to standard procedures encountered in the application of a given technology. Task analyzability is defined as the extent to which, when an exception is encountered, there are known analytical methods for dealing with it (see, Hatch, 1997). Obviously, applied technologies in different production regimes have different skill requirements from employees using technologies. For instance, the importance of specialist knowledge for producing good quality work, and of maintaining a personal relationship with customers, is recognized as an inhibitor on full flexibility. "Preeminent cultural change has promoted the values of quality of product or service and the preeminence of the market, sanitized into customer sovereignty or 'customer awareness/customer care' (Legge, 1995: 44)".

In principle, all non-managerial staff could be deployed totally flexibly between tasks and different areas of the factory. In practice, full flexibility might be neither achieved nor sought. Labour flexibility is a means rather than the end. Temporary workers as implied in numerical flexibility, for instance, are more likely employed in the traditional fashion to meet production peaks and as a buffer against fluctuation in demands (Stark, 1995). And the policy of large-scale employment of temporaries, by creating a new status divide (Wielers and Schippers, 1998), paradoxically, resulted in a new rigidity, rather than flexibility (Geary, 1992). Hence, flexibility, when coupled with cost effectiveness, leads to 'labour intensification' that is largely promoted through systems of bureaucratic control, although the rhetoric may imply cultural change (Legge, 1995; Elger, 1991).

Besides product/ market/ technology dimensions on flexibility, there are as much political and legal constraints on flexibility as culture and norms of individuals hold against insecurity accruing to flexibility. Flexibility achieved informally by headcount reductions may subsequently be formalized without a constant revision. Furthermore, management and employees' interest in their 'ownership' of particular work areas poses constraints on the development of functional flexibility, since many employees are more suited to, and interested in, some areas of work rather than others. As Legge (1995: 42) notes, "Much

functional flexibility via job enlargement and labor intensification, coupled with management effort to enhance its control over resulting flexibility, has occurred almost by the back door as reductions in head count as part of cost-cutting exercises have resulted in smaller numbers of employees covering an unchanged set of production requirements."

Very often in the name of flexibility the ability to adapt to the changing market demands and the need to manage adjustment are subject to structural rigidities and various institutional constraints (Rosenberg, 1989). This entails important structural change, major technological advances, new forms of work organization, requirements for particular skills and a greater degree of labour mobility. In this light, flexibility as a condition of economic recovery and future development, takes on a more dynamic character, provoking a rethinking of our institutional legacies, of the adaptability of labour institutions and work force (Laflamme et al, 1989).

In China, the need for labour flexibility originally evolved from the government intention to eliminate employment rigidity prevailing in the state sector (see chapter 2). In the past, state managers had little control over hiring, firing, or paying workers (White, 1982; Walder, 1987). The wide range of welfare functions of enterprises led to the extreme immobility of labour (Walder, 1989). This immobility further limited managers' discretion over the effective use of labour in response to fluctuation of product markets (White, 1982; 1987a). Because it was easier to expand than to contract the labour force, enterprise managers refrained from undertaking risky ventures that would leave them with the permanent liability of a large labour force in case of failure (Byrd and Tidrick, 1987; Krug, 1990). And the fact that management was not allowed to discipline unproductive workers through dismissal led to *management inability* (Lockett, 1990). This means that incentives for productivity increases were largely lopsided in the state sector (Child, 1994).

The move to labour flexibility was accelerated in the mid-1980s when the labour contract system was introduced to state-owned enterprises. As indicated in chapter 2, the introduction of a labour contract system was aimed at removing employment rigidities associated with the so-called 'iron rice-bowl' (White, 1987b; Warner, 1995). The 1990s' market-oriented industrial reforms further pushed dinosaurs SOEs to the forefront of market competition, thus confronting over-manned SOEs with the danger of survival (Warner, 1997). The problem becomes further more pronounced as SOEs come to compete with newly emerged competitive entrants (mainly non-state firms) employed with more flexible workforces (Howell, 1993; Krauz, 1989; Krug, 1997). The labour reform, by introducing flexibility into employment relations is seen as a way to revitalise state firms (Korzec, 1992). Hence, labour flexibility has increasingly become a trend of both the government labour reform change and the enterprise personnel management.

As pointed out in chapter 2, China's labour market is a market in which unskilled labour is in excess supply while skilled labour is relatively scarce. Firms and managers therefore need to find effective ways to achieve higher mobility of unskilled labour while keeping skilled labour in the organization for both cost effectiveness and value addition. As a priority in recent labour reforms, flexibility in employment and compensation is deemed to enhance management's discretion in the adjustment of the size and volume of the workforce to market fluctuations. Flexible employment relationships can also free workers

from the firm where they are employed, thereby promoting labour mobility (Warner, 1995; 1997; 1999). Workers would be inherently better off and better motivated if they had more options to move to productive positions (Zhao and Nichols, 1996). For the government, greater flexibility in shedding redundant workers would spiral unemployment to a high level, while the resultant higher inner pressure of the remaining workers may force the firm's managers to focus on efficiency gains after downsizing (Pfeffer, 1999; Cameron, 1994; Benson et al, 1998). In the face of intensified competition in product markets, the firm's management tends to seek higher labour flexibility to maintain a comparative advantage over its rivals.

Nevertheless, flexibility seems attractive to managers who have more power over labour. But it also offers some advantages to workers. Flexible employment relations, for instance, are often associated with more stimulating, and conceptually demanding jobs. This in turn requires workers to possess multi-skills capable of rotating among a variety of interesting jobs. However, it would also be surely wrong to conclude that in the move to flexibility unions and workers have to accept all hinds of concessions just for the sake of survival of the enterprise (Laflamme, 1989). Therefore, flexibility is not only a question of the needs of the firm and its flexibility strategy for economic rationality, it also should take account of a socio-political context wherein government labour policies, unions presence, management coalition, and legal regulations cannot be ignored.

3.2.4 Concluding remarks

The foregoing sections reviewed the concept of labour flexibility and its different dimensions as related to consistency of the firm's HR system. It was shown that the firm's human resources as a source of sustained competitive advantage could be utilized in a flexible manner for the attainment of strategic goals of the organization in the turbulent business environment. For labour flexibility to be achieved at the workplace the firm's HR practices and policies should be consistent with each other to support management's effort to increase labour flexibility in the organization. Moreover, various forms of labour flexibility, as indicative of two contrasting employment strategies (*cost-cut* and *value-added*), can be strategically and pragmatically deployed to explore the workforce's skills and efforts in the same organization. Therefore, flexible utilization of the organization's competencies and capabilities embodied in the employees is the primary goal of management. This forward-looking, strategic perspective on flexible labour practices thus departs from bureaucratic, traditional personnel management with an emphasis on labour control under a stable business environment.

3.3 Theoretical perspectives on labour flexibility

To study management's pursuit of labour flexibility (the central question of this research) in the enterprise under conditions of transition in China, three relevant theoretical perspectives shall be taken as starting points for an analysis. They are (a) strategic choice,

(b) transaction cost economics (cost and benefit perspective), and (c) institutional constraints that operate in managerial decision-making (see Figure 3.1) (Buitendam, 1994).

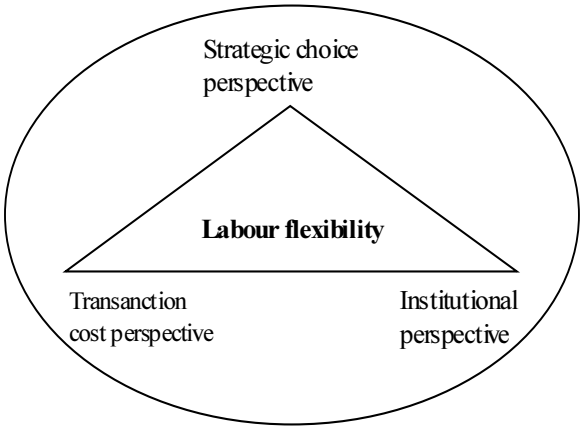

Figure 3. 1. Perspectives on labour flexibility

3.3.1 The strategic choice perspective

The strategic choice perspective focuses on relationships between the organization and its surrounding environment while emphasizing managerial discretion or choice (Cyert and March, 1992; March, 1988, 1994). Two different views emerged among the early analyses of organizational structures and managerial behaviour. One was the environmental determinism, which regards environmental conditions as ultimately determining of organizational characteristics (e.g. Pugh et al, 1963; Donaldson, 1985; Hannan and Freeman, 1989). Another, the action determinism, concerns the possibility that "actions are selected according to in-built preference and information processing systems of actors" (Whittington, 1988: 524). Although different in their response to the environment, both schools of determinism acknowledge the effect of environments on the organization. The importance of environment to managerial choice has been acknowledged by many scholars, such as those of the institutional school (e.g. Selznick, 1982; Gouldner, 1973). Although, as Perrow (1972, 1986) noted early on, this school "has taken the environment seriously and tried to understand the organization's relationship to it" (ibid.: 176), there is a variety of organizations. "Organizations do 'adjust' to environmental changes...but the desire is to control and manipulate the environment" (ibid.: 188). This perspective emphasizes aspects of strategy, alternatives and managerial discretion.

Child (1972:2) defines *strategic choice* as "the process whereby power-holders within organizations decide upon courses of strategic action." And "such action could be directed towards different targets" (Child, 1997: 45) in response to the shift of environmental constraints by designing an organization's structure. Strategic action, in Child's (1997) view, could be both external-oriented and internal-oriented in nature. External oriented

actions may include a move into or out of given markets, or secure favourable transaction terms of the organization with external partners. Whereas internal actions may involve an attempt, within the limits of resource availability and indivisibility, to establish a configuration of personnel, technologies and work organization that is both internally consistent and compatible with the scale and nature of the operations planned. Strategic choice is mainly performed by key actors with managerial initiatives through pro-action as well as re-action within the network of internal and external organizational relationships.

Strategic choice analysis recognizes a dynamic interaction between the environment and its constituent organizations. The strategic choices made by managers are subject to their perceptions of the environment and of their organizations' capabilities. The success of these choices rests on how well competitive strategy matches environmental conditions and whether organization structure and management processes are properly fitted to strategy (Miles and Snow, 1984; 1996; Perrow, 1986). People in organizations can 'enact' their environments in the sense of 'making it happen as they wish' (Weick, 1969; Pfeffer et al 1978). This is in contrast with the 'task environment' view that focused on the given consequence of economic and technological conditions. Whittington (1988) points out that the social structuring of environments may enable as well as constrain strategic choice. In reality, organization and environment are becoming inter-penetrated through collaboration between actors in such a way as to diffuse the distinction between the two entities. The most likely result is in the form of joint ventures and other strategic alliances (Lorange and Roos, 1992) and, incidentally, blurs the distinction between 'firm' and 'market'. Strategic choice analysis therefore allows for the objective presence of environments while, at the same time, recognizing that organizations and environments are mutually pervasive, as a consequence of managerial (pro-active) behaviour.

Effective strategic choice, however, involves the exercise of power within and among organizations. The issue of power relationships essentially stems from the resource dependence of the organization upon the external environment that was originally elaborated by Pfeffer and Salancik (1978). The resource dependence theory assumes that all organizations depend on a flow of critical resources (e.g, money, technology, and skills) into the organization for continuing functioning. The ability of external parties to command critical resources gives those parties power over it. The command of critical resources is the basis for inter-organizational power (Pfeffer, 1981). Even within the organization, power relationships exist and affect, for instance, the development of firm internal labour market practices, such as internal promotion rather than hiring from outside (Pfeffer and Cohen, 1984).

To some extent, organizational leaders can take steps to manage, and even reduce, their dependence on external parties. One method for reducing dependence is to internalize external parties by integrating them into the organization (e.g. recruiting from outside), or by seeking good "..relationships with people who are formally outside the organization" (Child, 1997:57). This echoes two strategies for environmental management: *buffering* and *bridging* proposed by Neergaard (1992). "Through buffering, managers intend to protect their core activities form external influence; with bridging, managers endeavour to manage their environments through various forms of negotiation, co-operation, exchange of information and other forms of reciprocity" (Child, 1997: 59).

Strategic choice, when followed up by strategic actions, has direct impact on the outcome of the organization's performance. The key actors thus tend to take the consequences of their actions seriously. However, an accurate and objective assessment of the consequences is subject to constraints of the actors' limited knowledge, understanding and prior preferences. This is because the values of the senior decision-makers of the organization influence their strategic decisions, as well as the outcome (Andrews, 1980), which govern their behaviour. When the behavioural imperatives of decision makers' values match those of their chosen strategy, the likelihood of successful strategy adoption and implementation will be higher than when the same imperatives conflict (Pant and Lachman, 1998). Hence, strategic choice notes the role of values and relational norms in moulding organizational actors' behaviour within a societal acceptable domain (Child, 1997).

Moreover, strategic choice analysis promises a bridge between individual learning and organizational evolution with an attention drawn to the action-structure nexus, and the attendant process of structuration (Child, 1997). It recognizes that the resultant bridge between the organizational actors who learn and the organizational structures and routines, both influence and are influenced by the learning process. Learning can take the form of '*single-loop'* through *'learning-by-repetition'* or the form of '*double-loop'* through *'learning-by-improvisation-and-reflection'* (Lado and Wilson, 1994: 706). It adds the insight that the process of organizational evolution is "mediated by a 'consciously-sought adaptation to, and manipulation of', existing internal structures and environmental conditions" (Child, 1997: 67). It emphasizes the competencies and the intentions that actors possess to achieve organizational adaptation, as well as initiatives that actors take in collaboration or competition with external parties. As such, the strategic choice perspective provides a bridge to human resource-based views of firms with focuses on initiatives, pro-active behaviour and managerial discretion. It regards learning as a social rather than a purely individual phenomenon, and explains how individual learning is translated into enhanced organizational capabilities, and how these are formalized into innovative policies and procedures. It recognizes that "people in organizations often belong, or have access, to both intra- and extra-organizational social groups" (Child, 1997: 68).

In short, strategic choice perspective sees strategies as a means by which firms negotiate their environments. It brings an organization's agents and structure into a 'dynamic tension' along the subjective-objective dimension. It locates this relationship within a social context as the source of agents' values and perceived interests towards the organization. It also locates the relationship within an economic or institutional context that is relevant to how an organization performs objectively in terms of its capacity to attract further resources. Moreover, strategic choice perspective locates learning within organizations and their environments as socially constituted systems (Child and Czegledy, 1996). Strategic choice analysis, with its focus on organizational actors, views the evolution of an organizations' environment as a product of actor's proactive decisions and not just as a passive environmental selection process.

As with strategic choices of labour flexibility, two employment strategies (*cost-based*, and *value-added*) are implied when management attempts to take use of various forms of flexible practices in the organization under environmental constraints. On one hand, enterprise managers need to understand interactions between the firm HR practices and the

surrounding regulatory environment. On the other, management has to forge a *strategic interaction* between a firm's HR capabilities and its strategic goals of the organization in a competitive environment. This is why most companies adopt both the cost-based employment strategy and the value-added employment strategy simultaneously in the same organization (Grant, 1991; Wright and McMahan, 1992; Guest, 1989). Here, a key point of managerial strategic choices in the area of HRM is how to respond to and interact with the environment. Once that choice has been made, then consistent HR policies and practices must match it. The underlying hypothesis is that organizations with the appropriate response and the right match will result in superior outcomes.

In China, the market-oriented economic reforms have brought the individual enterprise as an increasingly important locus for strategy and decision-making on human resource management and employment relations. Within the enterprise, the management has acquired the increasing autonomy over business operations and personnel management. Under such circumstances, it can be assumed that employment strategies (*cost-based and/*or *value-added*) as implied in flexible work practices adopted at the workplace reflect strategic choices of management on the basis of perceived costs and benefits under the changing business environment.

3.3.2 Transaction cost (and agency) perspective

Transaction cost economics is mainly concerned with the governance of contractual relations that incurs transaction costs in 'buy' or 'make' decisions (Williamson 1975, 1985). Under certain circumstances, non-market modes of economic organization are more efficient than market modes. The comparative efficacy of alternative modes of governance varies with the institutional environment on the one hand and the attributes of economic actors on the other (Williamson, 1995: 212). The main task of management is to create a system of corporate governance that is efficient (minimizes production and transaction costs) as well as effective (realizes the objectives of the firms).

The transaction cost perspective recognizes the *human* and *environmental* factors in influencing organizations to seek internalizing transactions (as opposed to transaction in markets) as a means of reducing the transaction costs. The environmental factors consist of *uncertainty* or *complexity* and *small numbers of exchange* (Williamson, 1975). The influence of these factors on human behavior is manifested when two parties commit to a recurrent exchange governed by a contract. This is so because the recurrent transaction is subject to two typical human factors, i.e. *bounded rationality* and *opportunism.* Simon (1957) defined the bounded rationality as behaviour that is "intendedly rational, but only limitedly so". Opportunism refers to the fact that people tend to act with self-interest and guile in pursuing their own goals (Williamson, 1975). As such, "all complex contracts are unavoidably incomplete by reason of bounded rationality, and the convenient concept of contract as promise (unsupported by credible commitments) is vitiated by opportunism" (Williamson, 1996: 6). These two human factors, when coupled with the environmental factors, serve as major obstacles to human exchange.

Transaction costs are the costs associated with negotiating, monitoring, evaluating and enforcing exchanges between parties in order to make exchange more efficient. Transaction cost economics holds that economizing on transaction costs is mainly responsible for the choice of one form of organization over another. In Williamson's words (1995), 'using a simple structure to govern a complex transaction invites strain, and using a complex structure to govern a simple transaction incurs unneeded costs'. Within the institutional order of capitalism, each generic mode of governance---market, hybrid, and hierarchy --- possesses its own logic and distinctive cluster of attributes. As market transaction costs increase, there is a tendency to internalize the transaction within the organization. In contrast, outsourcing of tasks is pursued when the tasks are strategically unimportant and loosely connected to the core competence of the firm. But "outsourcing often entails a significant loss of transactional flexibility, making it inappropriate for the core tasks" (Baron and Kreps, 1999: 460).

In particular, employment is a complex transaction that involves time and uncertainty. The bounded rationality of the parties involved implies that the term of the employment contract cannot be spelled out completely in advance, it must be formed as time passes and contingency arises (Baron and Kreps, 1999). By applying transaction cost analysis to employment relations, Williamson et al (1975) notes *idiosyncrasy* of employment relations in circumstances where workers acquire significant job-specific skills during their employment. The notion of idiosyncrasy is identical to asset specificity, here referring to firm-specific skills. Such firm-specific skills are not freely available at the external labour market, but have to be acquired by work experience on the learning-by-doing base, or through investment in on-the-job training. Because both employer and employee develop transaction-specific assets that leave each liable to holdup by the other party, the transaction of asset specificity is crucial for the magnitude of costs when it is subject to *bounded rationality* and *opportunism*. The skill idiosyncrasy can result in first-mover advantages and bilateral monopoly situation because investments in idiosyncratic types constitute a potential source of monopoly (Creedy and Whitefield, 1988). Hence, the parties may resort to relational contracting. Generally, relationship-specific investments are important and transaction costs make it impossible to write a comprehensive long-term contract to govern the terms of the relationship.

In order to reserve workers skill idiosyncrasy in the organization, Williamson (1981) points out that an appropriate governance structure should be designed to suit the nature of different human assets. This is so because firm-specific skills can generate an economic advantage to the firm. For firm specific human assets, a protective governance structure is needed to accommodate human specificity for the efficiency purpose. The extent to which firm-specific skills are relevant, combined with the degree of easiness in measurement of the added value in fulfilling jobs, leads to the development of a four-fold configuration of employment governance structures, namely, *spot market*, *obligation market*, *primitive team*, and *relational team* (see figure 3.2).

		Human assets	
		Non-specific	*Highly specific*
Metering	*Easy*	Spot market	Obligation market
	Difficult	Primitive team	Relational team

Figure 3.2. The governance of employment relations
Source: Williamson (1981: 565).

In brief, *internal spot market* is characterized by non-specific skills in human assets and easily metering performance of non-specific skilled workers. Such workers "can move between employers without loss of productivity, and firms can secure replacements without incurring start-up costs" (Williamson, 1981: 563). *Primitive team* is such that the work cannot be individually metered easily. But human assets are non-specific in the sense that the membership of such team can be altered without loss of productivity. *Obligation market* involves a considerable amount of firm-specific learning, but tasks are easily metered. Both firm and workers have an interest in maintaining the continuity of such employment relations. In *relational team*, human assets are highly specific to the firm, and tasks performed are difficult to meter. A "clan" form of work organization evolves to accommodate feministic relations inherent in employment.

Accordingly, different internal governance structures are proposed to match internal transactional attributes of human assets that differ in skill specificity, as well as in metering of productivity (Williamson, 1981). For internal spot market workers, to less extent, primitive team, there is no need for a special governance structure to sustain employment relations. Instead, the employment relations can be terminated when either party is sufficiently dissatisfied. For the obligation market workers, however, procedural safeguards shall be devised to discourage arbitrary dismissal and unwanted quitting. Relational team type of employment is subject to considerable social conditioning, given the fact that both the firm and employees make a great commitment to each other. Hence, the firm should provide employees with considerable job security, while employees in return are dedicated to the purposes of the firm. As a result, a mutual dependence is likely to develop in relational team.

In recent years, transaction cost economics comes to term with agency theory and, to a less degree, with property rights economics in organization studies (Hart, 1996). The agency theory is concerned with contractual relationships between principals and agents. The agent in a principal-agent relationship is employed by the principal to perform some service on his behalf. The main concern of the principal is to ensure that the agent acts in principal's best interests. A typical problem arising in this regard is that the principal cannot perfectly and without costs monitor actions of the agent (Nilakant and Rao, 1994).

The challenge of inducement and enforcement comes to the fore even if the principal has established an ex ante contract between their two parties (Hart, 1995).

The agency theory takes a contractual framework for efficiency as given by stressing the issue of monitoring. It claims that problems of organization stem from principals entrusting tasks to agents. For instance, the employer (principal) in his attempt to achieve a preferred outcome is hindered by some kind of dependency of the outcome upon the strategic decisions of the agent (managers or employee). Often, an asymmetric distribution of information between the principal and the agent(s) makes the principal vulnerable to the agent's strategic behaviour. Moral hazard and adverse selection problems arise in most cases. The principal-agent analysis tries to show which set of institutional structures can reduce these problems and can lead to the optimal outcome (Baiman, 1982; 1990).

The principal-agent perspective takes the ownership of firms and allocation of transaction as a given, and concentrates on the design of ex-ante employment contracts and information systems. To avoid losses caused by agents' potential opportunistic behaviour, principals either go to monitor agents or, alternatively, induce them to cooperate by designing attractive incentive schemes. For monitoring, the principal has to overcome the problem of asymmetric information distribution. For designing attractive incentive systems, the employment contract should allow for flexible reward schemes, like bonuses and profit sharing options, which are in line with the marginal productivity of the individual employee. With respect to employment relations, the agency theory sees an advantage of internal labour market that permits development of appropriate incentive systems that harmonize agent and principal interests.

In short, transaction cost/agency perspective can help to explain appropriate employment governance and effective means of controlling employee behavior. Often, employment is "an open-ended transaction, with the details of the transaction specified only as time passes and relevant contingencies arise" (Baron and Kreps, 1999:62). Moreover, a central premise implied in this approach is that employees have strong incentives to shirk and free rider with guile. Reliance upon designing a special incentive system alone cannot ensure to elicit an expected effort from the workforce unless task conditions allow employees to demonstrate their unique contributions and to benefit from those contributions. Hence, the main task of HRM is to formulate an effective monitoring system that allow for the measurement of unique contributions and provide adequate rewards for individual employee performance (Jones, 1984). These control systems are means of monitoring employee behaviour through which management should be able to align employees' efforts towards the strategic goals of the organization.

Agency-related problems have recently been reported in Chinese SOEs and some joint ventures where managers act as agents on behalf of the state, namely, the principal (La Croix et al, 1995). It is often found that Chinese state managers are always able to pursue their own interest at the expense of state firms seeking favourite contract terms in bargaining with the state bureaucracy under the Contract Management Responsibility System (CMRS) (Krug, 1990; Child 1994). The favourable contract terms not only mean more room for management to maneuver in the face of uncertainties, but also imply an attractive term of management under CMRS. Under such circumstances, it could be

rational for managers to seek maximizing of their own and employees' stream of wages, bonuses, and benefits in kind, sometimes in the detriment to enterprise growth (Nolan and Dong, 1990). As a result, the more one sees grants of autonomy allowing managers to pursue private goals, the less effective the agency relation between owners and managers (Putterman, 1995). Therefore, the devolution of some rights to enterprise managers in China should be seen as the adjustment of an agency relationship, rather than a shifting of the locus of ownership. Accordingly, any change in managers' behaviour should be seen as a response to strengthening incentive systems through pay and appointment mechanisms so as to elicit from them performance consonant with their own goals.

3.3.3 Institutional perspective

In contrast to transaction cost economics focusing on an efficiency aspect of the governance of transactions, the institutional perspective takes a broad approach (sociological and/or political) to organizational behaviour. The sociological brand of institutional approach emphasizes the ways in which human action is structured and order made possible by shared systems of rules. The shared systems of rules can "both constrain the inclination and capacity of actors to optimize as well as privilege some groups whose interests are secured by prevailing rewards and sanctions" (Powell and DiMaggio, 1991: 11).

The political approach, on the other hand, is concerned more with political decision-making, especially about the ways in which political institutions shape organizational outcomes (Shepsle, 1986). Here, political institutions are viewed as "ex ante agreements about a structure of cooperation" that "economize on transaction costs, reduce opportunism and other forms of agency 'slippage,' and thereby enhance the prospects of gains through cooperation" (Shepsle, 1986: 74). Although an integrated institutional theory is currently not well developed and consists of a variety of strands, the new institutionalism in organization theory tends to focus on a broad but finite slice of sociology's institutional cornucopia: organizational structures and processes that are industry wide and national scope. To a great extent, sociological and political brands of institutional perspectives both stress institutional environments as socially constructed normative worlds. They recognize impacts of habits, conventions, beliefs, social obligations, ideology, and institutional heritage on individuals' behaviour in the organization (Oliver, 1991; Scott, 1987).

Recently, Biggart (1997) points out four elements in institutional theory of economic organizations. These are economic action as social action, the embeddedness of economic activity in institutional settings, institutional logic as a crucial concept, and the necessarily multilevel nature of an institutional argument. In his view, economic and organizational activities are not apart from society, but are embedded in it. And "organizations are the consequences of people working out routine means for handling repetitive economic functions (ibid: 28). The shared interpretations of action, or 'typifications', in Scott's words (1987: 495), "are attempts to classify the behaviour into categories that will enable the actors to respond to it in a similar fashion. The process by which actions become repeated over time and are assigning similar meanings by itself and others is defined as *institutionalization*".

Obviously, most institutional theorists accept the organizational structure and career lines as given, and inquire about individual adaptation to a socially structured reality (Scott, 1987, 1992; Powell, 1990). They focus on the formation of norms, customs, rules of conduct, and interpersonal comparisons within the firm, independently of efficiency properties (Kerr and Staudohar, 1994). They reject the premise that organizational phenomena are the products of rational choice based on pure economic or technical considerations (Westney, 1993). Instead, they stress the importance of social and political forces inducing legitimate organizational uniformity and stability (Roberts & Greenwood, 1997), and argue that economic activities are embedded in networks of interpersonal relations (Whitely, 1992). The cognitive and socio-political legitimacy, or cognitive and normative expectations, constitute environments as overly constraining individuals' behaviour (Scott, 1995).

Institutions have functions of reducing uncertainty by providing dependable and efficient frameworks for economic exchanges (Scott, 1987; North, 1990). Uncertainty may come from the unstable environment, but it may as well be generated by the advent of new technologies (Thompson, 1967). The resultant institutional framework of a society serves to regulate economic activities by providing the rules of the game. 'The rules of the game' consist of both formal and informal constraints that regulate individual and organizational behaviour. Formal constraints include political rules, economic rules, and contract laws. Informal constraints, on the other hand, encompass codes of conduct, norms of behaviour, and convention, which are embedded in the culture and ideology. Once formal constraints cease to work, informal constraints will come into play. "Although formal rules may change overnight as the result of political and judicial decisions, informal constraints embodied in customs, traditions, and codes of conduct are much more impervious to deliberate policies"(North, 1990: 6). In particular, constant interactions between institutions and their constituent organizations shape the outcomes of aggregate economic activities of individuals in the group. In other words, institutions provide the rules of the game to organizations and individuals that act and compete in acceptable ways justified by norms in society (Scott, 1987).

More recently, some scholars take an evolutionary approach, and view institutions in transition economies as products of deinstitutionalization and reinstitutionalizaion which involves random variation, selection, and retention (Grabher and Stark, 1997; Orru et al, 1997). Here, deinstitutionalization refers to processes of dismantling the legacies of state socialism that block the promising road to free markets. Reinsitutionalization is another way around, and implies that a set of new institutions supporting transactions of market-oriented organizations or economic actors. It is assumed the post-socialist 'transition' to markets as the replacement of one set of economic institution by another set of institutions of proven efficiency. Stark (1997) indicates that the collapse of the formal structures of the socialist regime in Eastern Europe does not result in an institutional vacuum. Instead, the persistence of old routines and practices, organizational forms and social ties "can become assets, resources and the basis for credible commitments and coordinated actions in the post-socialist period" (p. 36). In other words, institutional legacies of state socialism embody not only the persistence of the past but also the resources for the future. The resultant institutional friction between the legacies of the old and the newly established ones keeps open a multiplicity of alternative paths to further exploration of new solutions.

In transition economies as in China, environmental uncertainties may be caused by the unpredictable behaviour of business partners, opportunism, bankruptcy, or sudden major re-reorganizations. But environmental uncertainties are more likely to be generated by weak economic institutions (Krug and Polos, 2000). As uncertainties translate into risks for which a high premium needs to pay, economic agents have a strong incentive to search for institutional solutions to safeguard their interests. While a market compatible institutional framework in China's transition context is still evolving so that the "rule of the game" has not yet established to regulate behaviour of economic agents. The evolving institution environment is such in which the remains of the socialist past are at work and the newly introduced market mechanism weak. Under such circumstance, behaviour patterns of economic agents display 'recombinant' characteristics of the half market and the half state socialist past (Stark, 1997).

Recombinant institutions have strong impacts on the firm's HR system as well as on labour flexibility practices at workplace. First, the firm's HR system is part of a broad institution that set a scope for or limit on flexible work practices adopted at the workplace (Ackroyd and Procter, 1998; Baglioni, 1990). Second, the "path-dependency" works in the sense that organizational practices shaped by historical factors have an enduring impact on the subsequent change (North, 1990). Third, and related to the second, institutions have inertia of their own (Scott, 1987). Once established, institutions tend to persist and continue to work even though they are perceived sub-optimal (Wilkinson, 1996). Hence, it is not surprising that some firms adopt a new set of HR practices while are stuck in legacies of the old HR systems. As a result, inconsistency in the firm's HR system arises and poses constraints to management in the pursuit of labour flexibility.

3.3.4 Discussion and applicability

The three perspectives reviewed above are not exclusive to each other, rather they provide complementary insights into managerial decision-making through which the company's key actors seek to increase labour flexibility under the changing institutional environment. The strategic choice perspective stresses a dynamic interaction between the organization and its constituent environment. It views the environments of organizations as both enabling and constraining for strategic choice. Transaction cost analysis focuses on efficiency by highlighting the importance of the organization's governance for a transaction cost economizing while it neglects the influence of socio-political factors in shaping contractual relations over time. The socio-political factors are picked up by institution theory that stresses rules, norms and customs in legitimizing individual behaviour patterns in society. In the words of Granovetter (1985), transaction cost theory provides an undersocialized account whereas institutional theory offers an oversocialized perspective.

Although the three reviewed perspectives differ in their analytical focus and orientation, each alone cannot fully explain what was happening in the area of HRM in China's transition economy. In combination, these three perspectives may provide an integrated insight into management decision making with respect to labour flexibility under the transitional context. As noted above, strategic choice analysis stresses the role of the

organization's key actors in initiating, shaping, and directing strategic reorientation towards the environment. This is particularly relevant in analyzing the increasing role of management in the post-reform socialist economies. It can be expected that forces to shape the contour of HRM in enterprises will mainly come from management in initiating the firm's HR policies and practices in the line with corporate catching-up strategies (*survival* and *development*) under the new business environment (Lu and Child, 1996; Krug and Buitendam, 1998). In particular, strategic choice analysis highlights a strategic fit of the organization's competitive strategies with its internal resources and its external environmental challenges. By linking the firm's HR system to the corporate strategy, it may reveal how concrete HR practices and policies are contingent, and not necessarily fixed.

Transaction cost economics, coupled with the principal-agent theory, provide fundamental concepts to understanding costs and benefits of specific forms of labour flexibility adopted at workplace. As indicated in chapter 2, intensifying market competition forces the firm's management to be more concerned with cost minimization to maximize profits for the survival as well as for the continued operation (Fan, 1994). This implies that enterprise managers would align flexible HR practices with the firm's competitive strategy to pursue higher labour productivity under constraints. Constraints on flexibility may manifest mainly through the firm's corporate governance and HR system. The four-way classification of the employment relation (*spot market*, *primitive team, obligation market, and relational team*) proposed by Williamson (1981) provides an instructive tool to analyze variable labour contracts on employees in firms. Similarly, in-house "*making*" and "*buying*" on markets are two alternatives to ensuring that the organization has the necessary competencies (skills and abilities). Yet, when an organization experiences decline, management tends to reduce in-house training programs, or turn to outsourcing. This is so because "transactions, which differ in their attribute, are aligned with governance structures, which differ in their costs and competence, in a discriminating---mainly, transaction cost economizing---way" (Williamson, 1995: 225). Therefore, different types of labour flexibility that firms have sought and achieved can be perceived as an management effort to maximize the joint surplus through economizing on employment transaction costs, or to reduce costs of unwanted labour turnover in the organization.

The fundamental problem inherent in the transition from state socialism to market is that most elements of the old system were interrelated (Nolan, 1996). Replacing the state regulations based on centrally planning with one based on market mechanisms is only a piece meal solution to some urgent issues in sight, while the fundamental problem remains in place (Naughton, 1995a). This is, to some extent, related to the process of deinstitutionalization and reinstitutionalization that run in parallel but conflicts in most of the transition economies (Child, 1994; Grabher and Stark, 1997). The so-called path dependency (North, 1990) is probably persistent in shaping the course of action for change, especially in the area of HRM. For instance, the norms of equity and fairness have a lasting effect on pay practices in organizations (Solow, 1990). They also define social legitimacy to organizations in terms of equal opportunities and the fairness of employment practices (Powell and DiMaggio, 1991; Scott 1995). Strong individual networks characterized in Chinese business systems in East Asia are powerful mechanisms not only for resource pooling, but also for risk mitigation (Whitley, 1992; 1994). These individual

networks also enforce desirable behaviour patterns in today's non-state firms in China (Krug and Polos, 2000). Apparently, the whole set of new institutions needs to be built to serve the new economic system if the market-oriented transition is deemed to be successful in the end. However, to establish such new institutions will take a long time, and the process of such reinstitutionalization will involve a series of ups and downs, as observed in China's transition trajectory (Naughton, 1995b). Under such circumstances, any managerial strategic choice in the area of HRM is inevitably subject to the formal and informal constraints of the changing institutional framework. Institutional constraints may vary with firms' ownership, age, as well as the embeddedness in a broad institution environment that is itself in transition.

All in all, the changing institutional framework, as well as unpredictable political factors, may set restrictions on the scope of managerial choice of HR policies and practices. The past institutional legacies and norms will also facilitate or hinder the pace of change of labour market practices. They may impinge on vested interests of the traditional personnel management. Against this background, the institutional perspective shall provide a helpful insight into managerially strategic choices of HR practices in response to market competition, when the new institutional framework is still under way. As Stevens (1995) claims, different management techniques are required for different types of constraints or opportunities. The key issue concerning people management is not the development of a particular process, but the adoption of a style of management that is appropriate to the circumstances

3.4 Analytical framework

Based on the above reviewed three perspectives on labour flexibility, an analytical framework is developed for the empirical study as proposed in chapter 1. The analytical framework should be suited to China's transition context.

In the literature, there are a variety of conceptual models that were developed for empirical studies of Western personnel management (e.g. Buitendam, 1979; Beer et al, 1984; Dunlop, 1994; Woodward, 1958; Ten Have, 1993; Kochan et al 1986). Among them, Buitendam (1979) established four task categories of personnel management, based on the structure and functioning of personnel departments in Dutch industrial organizations. The main impetus of his study was to explore differences in the functioning of personnel departments, in relation to differences in the characteristics of respective organizations and environments. Kochan et al (1986) formulated the three-tier model in capturing the transformation of American industrial relations in the 1980s. The model brought together key parties into a dynamic interaction at the three levels of industrial relations activity. It recognized the effects of various strategic decisions made the different actors on the established tripartite industrial relations system in the U.S. These models provide some fundamental concepts for a further study of HR practice and policies in different countries. However, the effectiveness of these models would be undermined if applied in developing countries without necessary modifications made with respect to the local institutional environments in which firms operate.

More recently, Verma et al (1995) have developed a new conceptual framework for a comparative analysis of employment relationships in the growing Asian economies. By taking into account industrial relations heritage of the specific country they locate industrial relations/human resource practices (IR/HR) at the center of their analytical framework. These are: the nature of work organization; skill formation; compensation; employment security and staffing; and finally corporate governance. They argue that changes in the patterns of employment practices should be seen as an adaptation of the firm in response to the external pressures arising from the changing macro economic and political institutions of the country. Following the logic of the conceptual model of Verma et al (1995), and inspired by the three theoretical perspectives on flexibility reviewed above, the following analytical framework is presented to conduct an empirical analysis of labour flexibility in companies under China's transition context (see Figure 3.3).

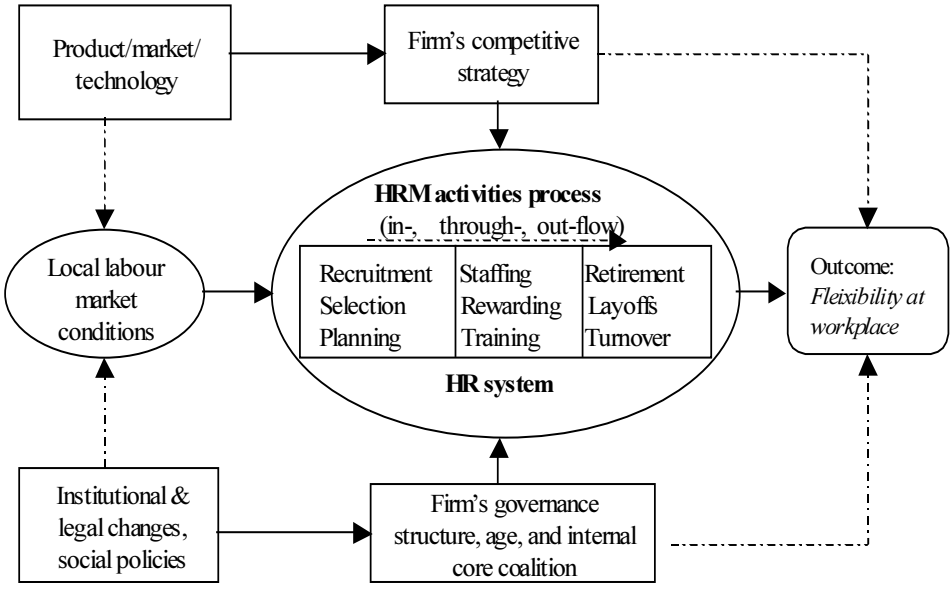

Figure 3.3. An analytical framework for the development of labour flexibility in companies

Note: arrows denote causal relationships, however the concomitant reversed relations exist as well. This research focuses mainly on the relationships indicated by solid arrows.

At the heart of Figure 3.3 lie main HRM activities in the company that cover a dynamic process of personnel flow in, through, and out (i.e. recruiting, staffing, rewarding, training, and manpower exit). The company's HR system governs these activities and has crucial impacts on labour flexibility at the workplace. The company's competitive strategies of *cost leadership* and/or *diversification* (Porter, 1985) entail corresponding employment strategies (either *cost-*

based or *valued-added*, or both), which is essentially the result of managerial strategic choices of specific flexible work practices under constraints. Hence, there are dynamic interactions among the company's competitive strategies, HR system, and labour flexibility strategies. Together, they are being shaped by and also shape the state of external labour market conditions and institutions (including legal systems). Labour flexibility practices adopted in the firm reflect management strategic response to increasing market pressures and advance in technologies that shift the locus of competition (*cost-based* or *value-added*). Equally important is the role of government social policies and industrial-level institutions in shaping the firm's HR systems, eventually management's incentives to increase labour flexibility at the workplace.

On the left side of Figure 3.3 lie three main changes that have occurred in China during the transition period. These changes serve as driving forces to push management to pursue labour flexibility in the company.

Competition in product markets. As set out in chapter 1, China's rapid economic growth over the past two-decade has transformed the country's product markets from a seller's one to a buyer's one. Shortage has become the thing of the past. A variety of goods are being sold and bought on markets with competition. Timely meeting customers' changing needs and their shifting preferences has become a key to the firm's success in markets. Intensifying competition (aggravated further by the entry of other new economic actors, mainly, non-state firms, and Sino-foreign joint ventures) has sharpened management's incentives to seek greater flexibility for survival and continued operations. For SOEs, hardening budget constraint on enterprise operations is an additional pressure driving management to contain labour costs and to increase labour flexibility.

The Advance of technology, here refers to the availability of various newly advanced technologies that pose impacts on the span of work control and subsequently the way work is organized in the company (Woodward, 1958; Ten Have, 1993). As noted in the second section of this chapter, although technology is not always suitable to flexible work organization, the growing use of computer-aided information technology enables the firm to produce a small batch of various products at the same time (Bosworth, 1996; Volberda, 1998). This emerging flexible production regime raises new skill requirements for employees. Skill formation on the job or over the career of individual employees then becomes a key HRM issue in facilitating the introduction of technological change and flexible forms of production. This in turn creates pressures for the adjustment of established work organization or adoption of new training arrangements.

The labour market conditions, refers to the supply of labour in relation to the demand in terms of quality and quantity. On the supply side, China has an almost infinite supply of unskilled labour for the foreseeable future, given its huge population base of 1.3 billion inhabitants in 1997, whereas skilled labour is relatively scarce. On the demand side, the deteriorating employment prospects in the state sector is in large measure set off by the growing employment in the private sector that has generated millions of new jobs (SSB, 1998: 127-138). Unemployment has been on the rise as a whole (for details, see chapter 2). Such labour market conditions offer great potential for the enterprise managers to explore numerical flexibility from unskilled labour, meanwhile they need to find effective ways of

keeping skilled labour for a long-term commitment, in addition to higher functional flexibility. Despite the general characteristic in China's labour market, significant regional labour market variations can be observed between inland areas and coastal areas. Wages in coastal areas are three times higher than in inland ones (SSB, 1998: 157-9). More new jobs are generated in coast cities by newly established firms due to the favoured policy environment (Ding et al, 1997; SSB, 1998: 156). Even in the same city, firms located in the special economic zones enjoy more favorable labour market conditions than those located outside (Murray, 1994). Hence, firms' geographical locations matter since different locations bring the firm quite different labour market conditions for management to seek labour flexibility.

Changes in government labour policies and legal systems. As spelled out in chapter 2, these changes encompass: 1) introduction of labour contract systems to replace the "iron rice-bowl" life-time employment in SOEs; 2) adoption of floating wage systems in which individuals' remuneration was linked to their performance, and use of bonus payments linked to the firm's profits that offered management a tool and incentive to monitoring employees' work efforts; and 3) other reform programs (such as housing reforms, welfare reforms, etc.). These changes in government labour policies were all aimed at inducing flexible employment relationships between the employees and their employing enterprise. On other hand, counter-forces arise in labour legislations with respect to labour protection. The 1994 new Labour Law, for instance, sets standard employment contracts and working conditions that provide a legal framework for management to explore labour flexibility in the company under constraints (Warner, 1996b).

The three sets of changes indicated above are not isolated from each other. There is a dynamic interaction, for instance, of product/technology and labour markets. A key feature of the product market pressures in today's China is that they are mainly transmitted through price competition (Economist, the, 1998b) rather than non-price competition (e.g. quality, design, reliability) (Murray, 1994). Similarly, the advert of new technology and the application in the company's production trigger labour market competition for new skills in the use of it since competing firms tend to shield risks of own training involvement (Ding et al, 1997). On the other hand, local labour market conditions are more subject to relevant institutions, legislation, and government social policies (Goodall and Warner, 1997; Laflamme et al, 1989). Consequently, the firm's employment policies are a product, and also a determinant, of the wider business strategies through which the firm seeks to compete.

The above three sets of changes have impacts on the firm's HRM, and eventually, labour flexibility at workplace, in different manners. Except for *external labour markets* that directly set loose or tight conditions for constituent firms to maneuver HRM (internal labour market) activities, other two sets of changes (i.e. *product market/technology*, and *institutions*) pose indirect impacts on the company level's HRM activities through the firm's *competitive strategy*, and its *governance*, *age*, *internal core coalition, and corporate culture* (see Figure 3.3).

Competitive strategy. According to Porter (1985), no firm can successfully perform at an above-average level by trying all products to meet market demands, or involving in business-unrelated activities. Managers need to select a strategy that will give the

organization a competitive advantage. A competitive advantage may arise out of either having lower costs than competitors or being significantly different from competitors. Accordingly, he proposes three competitive strategies that managers can choose from: *cost leadership*, *differentiation*, or *focus*. Cost leadership and differentiation strategies both seek a competitive advantage in a broad range of markets and industrial segments. The focus strategy aims at a cost advantage (cost focus) or a differentiation advantage (differentiation focus) in a narrow segment. The one that managers select depends on the firm's strengths and core competencies versus its competitors' weaknesses. When managers select cost leadership strategy, overhead is kept to a minimum, and the firm does everything it can to cut costs. The firm that seeks to be unique in its product offering and in its industry in ways that are widely valued by customers is following a differentiation strategy based on its internal competencies. Usually the focus strategy (either cost focus or differentiation focus) may be the most effective for small business firms as the case in China because most firms do not have the economies of scale or internal resources to compete with multinational companies since reforms. Instead, most firms have to focus on their core businesses in a single industry. The two focus strategies (cost or differentiation) have different implications for HRM in the company, which just correspond to two employment strategies (*cost-focus*, or *value-added*) identified by (Locke et al, 1995).

Firm's governance or ownership forms. As indicated in first two chapters, the two decades of economic reforms have transformed China's economy into one with increasingly market transactions. Individual enterprises are operating in a competitive business environment, and responsible for profits and losses in their operations. Newly emerged firms (mainly private firms, and foreigner invested joint ventures) are being established under corporate governance in the West sense. Most state-owned enterprises are increasingly coropratized to create joint ownership forms, of which the state only holds part of the stakes. As ownership rights of the firm are diversified, the state-business relationship has changed with the increasing enterprise autonomy, and declining state intervention. Subsequently, the so-called principal-agent problems arise in corporatized state firms since management may not always act in the best interests of principal, i.e. the state. This gives rise to the adjustment of internal reward systems, and the introduction of contract management responsibility systems (see chapter 2).

Age of the firm. The organizational sociology literature suggests that the age of a firm would inversely influence the rate of adoption innovations because organizational forms tend to be 'frozen' at birth (Stinchcombe, 1965; Osterman, 1994a). The firm at different lifecycles of growth is confronted with different liabilities and crises (Greiner, 1972), indicating different management challenges. Frequently, ageing of the firm implies 'organizational inertia' (Warner, 1999) due to *'administrative heritage* (Paauwe, 1996) or 'path-dependency' (North, 1990). In China, the age of the firm is linked to the nature of ownership: i.e. old firms are almost state-owned with the administrative heritage associated with the past state socialism, newly created firms after the economic reforms are not necessarily state owned. Apparently, the age of the firm has long-lasting bearings on the structure of human resources in terms of employees' age, skills, and behaviour since the firm's past HR structures, methods, competence, and values will affect the continued organization restructuring.

Internal core coalition. The dominant coalition is normally made up of the organization's key actors which can exert strong influences on the decision-making at the strategic level (March, 1988; Child, 1997). The composition of the core coalition members, and their ages, visions, and values they share not only affect the firm's growth strategy (Morgan, 1986), but also daily management, including HRM. In China (as noted in chapter 2), the two decades of economic reforms have restructured internal management authorities in state enterprises. Within the enterprise the directors and senior executives exert more control over daily management, and to less extent, strategic decisions (Lu and Child, 1996). The past powerful Party secretary in SOEs is now confined to ideological mentoring or integrated into a managerial position under CMRS (Steinfield, 1998). The 1990s' corporatization of SOEs, by creating corporate governance, has brought senior management under the Board of Directors as an internal core coalition (World Bank, 1997). Although the roles of the enterprise-based *trade unions* and *workers congresses* are still suppressed under the Party leadership, they occasionally voice employees' grievance in events of employee layoffs and unfair treatment by management (Ding and Warner, 1999). Consequently, management-labour relations are undergoing dramatic changes. However, in the history of firms evolved under the strong contextual influence as the case of China (Krug, 1997), above changes in governance and core coalition are inevitably subjected to broad institutional constraints, legal framework, and government social policies. Although these institutional factors are in a state of transition, the influences they exert on constituent firms cannot be neglected.

The above clearly shows that the extent to which labour flexibility to be achieved at workplace eventually depends on the macro level's economic institutional transition (including labour market conditions). Undoubtedly, it is increasingly associated with the firm's internal governance, age, core coalition, and corporate culture. Two decades of market-oriented deregulation and decentralization have penetrated into the firm's HR system allowing management to effectively use labour as a factor of the production at market prices. Meanwhile, the increasingly competitive pressure since the early 1990s has forced management to reduce production costs (of which labour costs make up large part), and to reorganize work in a more flexible manner. The nature of work, and work organizations has changed accordingly in line with market requirements. In other words, management's incentive for labour flexibility is being driven by the need for responsiveness to product market competition on one hand, and hardening budget constraints on the other.

Briefly, the specificity of the firm's governance (i.e. the nature of the firm's ownership), when interacting with respective regulatory institutions, tends to yield recognizable patterns of work organization. The resultant employment relationships in the firm are subject to institutional constraints. In this sense, variations in HR practices and policies with respect to labour flexibility between industrial enterprises in China can only be well understood under the changing context in which the firm's competitive strategies and its corporate governance structures play as much a role as do the surrounding institutions, and social policies. In other words, the company's HR practices and policies is not a self-contained domain of activities. The area of HRM activities needs to be understood in terms of related activities linked to broad social and institutional changes. These include the system of education and training and of labour market regulation, more broadly, the social security system.

3.5 Concluding remarks

This chapter has developed an analytical framework for an empirical study of labour flexibility in China's firms under the transition context. It has shown that labour flexibility in the West can be approached from two different dimensions, each exhibiting different attributes. In practice, various forms of flexible practices are deployed to contain labour costs, as well as to bring more value to the firm. These flexible practices can largely be categorized into two contrasting employment strategies: *cost-cut* and *value added.* The two employment strategies coincidently correspond to Porter's (1985) competitive strategies, both indicative of management considerations of labour costs and benefits at the strategic level. Three relevant theoretical perspectives shed light on labour flexibility from different angles, with different focuses. Although the three perspectives are applicable to an analysis of HRM activities in transition economies, each alone cannot fully explain management's incentive to increase labour flexibility in the organization in China's transition context. An integrated approach should be taken, importing concepts from the three perspectives. The proposed analytical framework modified with China's contextual features will be used to guide empirical analyses throughout the book.

What follows in the next chapter is an empirical research design based on the analytical framework developed here. An analysis of empirical findings on labour flexibility and HR systems will be given in chapters 5, 6 and 7, respectively.

Chapter Four

Methodology, Research Design, and Data

Introduction

This chapter is about methodological aspects of the research. Based on an analytical framework set out in the preceding chapter, two separate but related issues are addressed here: 1) how this empirical research was carried out in companies under China's transition context, and 2) what data were collected to answer the research question raised in chapter 1. The first question concerns the research design while the second question is about what research method applies.

The chapter consists of four sections. In the first section, case studies were taken as a main research method in this research. The research design was formulated in the second section, by referring to growth prospects of different industrial sectors, and local policy environments (including labour market conditions). Three industrial sectors were chosen to form the setting of the research, from which ten firms were selected from two cities for an in-depth investigation. This is followed by data collection methods used in the fieldwork (third section). The profile of data is presented in the fourth section. This chapter ends with a brief discussion of validity and reliability of data collected though case studies.

4.1 Research method: case studies

This research takes case studies as a main research strategy. In choosing an appropriate research strategy for an empirical study of management decision in companies, both the research question and the nature of the phenomenon were considered. According to Yin (1994), case study research is more suitable than other research strategies (e.g. surveys) in addressing both exploratory research of "what" and "how" and explanatory research of "why" questions. Sometimes, a clear-cut distinction is hard to make between exploratory and explanatory case studies. Scapens (1990: 266) points out, "an exploratory study, for instance, may be concerned with generating initial ideas to form the basis of an explanation…"

Often, case study research is used to investigate the phenomenon that is influenced by a number of variables beyond the control of the researcher. The validity of case study relies

on multiple sources of evidence secured in the research design. Yin (1994) distinguishes case research designs in two dimensions: the single/multiple case design and the holistic unit/embedded unit dimension. The first dimension refers to the number of cases being studied, while the second dimension concerns whether the focus of research is given to sub-units within a case.

As stated in chapter 1, this empirical study is exploratory and explanatory in nature (justified by the central research question). As an exploratory research, case studies were used to explore determinants and constraints behind management' pursuit of labour flexibility in the firm. The objective is to capture changes in work organization with respect to labour flexibility in China's manufacturing companies. By so doing, it aims to explain why management chooses different forms and types of labour flexibility in the organization of work. The focus is on the firm's external challenges and opportunities and internal strengths and weakness. In the course of case studies, available theories shall be referred in understanding and explaining the specific case, rather than to make 'generalizations'. If the applied theories do not provide convincing explanations, modification is necessary (Scapens, 1990: 265). Obviously, case study research is intended to generate preliminary investigations that are intended to produce ideas and hypotheses for rigorous empirical testing at a later stage.

In short, choosing case studies as the preferred research strategy for this research lies at the nature of research problem itself. Put precisely, it is the exploratory and/or explanatory research that determines case study as a most appropriate research method over others (e.g. surveys and experiments). Another related consideration is that case studies enable the researcher to make an in-depth investigation of the phenomenon through "access to actual behaviour events" (Yin, 1994), which seems plausible when one comes to analyze managerial decision-making in the area of HRM. Before detailing how data collection should be carried out in the fieldwork, a brief review of research design is needed.

4.2 Research design

The preceding section stated the nature of the research and the objective that the research is intended to reach. The objective, plus logistical and budgetary considerations (i.e. field study in China), influenced the design of the research work. This section will briefly describe how the empirical research was carried out in China. It concerns: 1) in which industrial sectors the empirical research was conducted; 2) locations of the fieldwork; and 3) the selection of case enterprises.

4.2.1 Three industrial sectors

This research is not intended to cover all industrial sectors. Instead it focused on industrial sectors, mainly manufacturing sectors. Three industrial sectors were chosen for an empirical study. They are the pharmaceutical sector, the special machinery sector, and the electronic and telecom equipment sector. In choosing the three industrial sectors for the study of labour

flexibility in manufacturing firms, two determinant factors (or criteria) were taken into account: 1) the extent of industry's openness relative to the state protection; 2) industry's growth prospect or attractiveness (Porter, 1985). These two criteria are roughly indicative of product/market/technology as noted in the analytical framework.

4.2.1.1 The extent of industry's openness versus the state monopoly

Since 1970, China's industry has been the largest sector of the country's economy. It has also been the source of the most intractable problems that market-oriented reforms targeted (Child, 1994). As indicated in chapter 1, the 1980s urban industrial reform started with the restructuring of state-owned enterprises for efficiency improvements. This gave room to the expansion of non-state firms that was left by state firms in almost all the industrial sectors. In today's China, except for defense industry and some other extractive industries that are still excluded from market competition, all industrial sectors are open to the entry of non-state firms (including foreign investment) (Ma, 1996). The extent of industry's openness to market competition, however, varies with the state dominance, which can be illustrated by the presence of state firms in terms of number and output in each sector (see Table 4.1).

Table 4.1. Number of industrial firms and their gross output values (percentage), by industry and ownership, in 1997

	Number of firms				**Output values (RMB.)**			
	Total	SOEs	Non-state firms	Of which: SFJVs	Total (¥100m)	SOEs	Non-state firms	Of which: SFJVs
Medical & Pharmaceutical sector	100% (5028)	35.30	64.70	14.71	100% (1262)	41.39	58.61	22.16
Special purpose machinery sector	100% (7916)	21.19	78.81	6.30	100% (2071)	42.41	57.59	10.18
Electronic & Telecom Equipment sector	100% (7345)	18.33	81.67	34.99	100% (3921)	22.80	77.20	63.13

Note: Figure in rackets is an absolute number; SOEs – state owned enterprises; SFJVs – Sino-foreign joint ventures, according to the Chinese official definition, include foreign involved equity joint ventures, cooperative enterprises, exclusively foreign invested enterprises, and enterprises funded by Hong Kong, Macao, and Taiwan (SSB, 1998: 444).
Source: SSB, 1998: 444-453, 456-457, 162.

The 1998 China's Statistic Yearbook clearly shows that by 1997, non-state firms outstripped SOEs in terms of number and output values in all the three sectors. In the heavy industry, state firms tend to be large in size but not dominate as compared to non-state firms. This is illustrated by a small number of state firms relative to their larger output share in the heavy industry. Heavy industry, however, is the least involved by foreign investment as compared to other two sectors (see the last column). In contrast, non-state firms are over-presented in the telecom-manufacturing sector. In particular, the number of foreign invested firms accounted for over one third and two thirds in output in the telecom sector. The figures suggest that the electronic and telecom equipment sector be largely exposed to market forces, particularly to international competition. At the opposite extreme stands the heavy machinery industry where large sized state firms predominate, with less presence of foreign investment. In the between lies the pharmaceutical industry where state firms and non-state firms compete with each other, with the modest presence of foreign investment.

To a greater extent, the presence of non-state firms vis-à-vis state firms indicates openness of industry vis-à-vis the state monopoly. Heavy industry, being regarded as of strategic importance to the entire economy, called for the dominance of state-owned firms over a long period of time in the past (Child, 1994). Although the number of non-state firms became majority participants in this sector in 1997, they were small in size as compared to state firms in terms of output values. Apparently, heavy machine industry remains dominant by state-owned enterprises that are less exposed to market forces after reforms. The pharmaceutical industry is a relatively lucrative sector that has attracted most firms for entry. It is also a sector that has vital impacts on people's health and safety. Hence, the government maintains strict regulations on the entry of non-state firms while encouraging competition for efficiency improvements. It is why in this industry both state and non-state owned firms coexist and have to compete, and state firms experienced drastic restructuring, as shall be shown later in the research. In the electronic & telecom equipment industry, which is relatively new and highly technological as compared to other industries, the state dominance is void. On the contrary, joint ventures and private firms predominate the telecom sector in terms of number and output, although the state protection remains in place (Economist, the, 1998a).

In short, the three industrial sectors are all exposed to competition, but they differ in the presence of different participating firms. The more the non-state firms presented, the less the state monopolies, and the more openness the industry to market competition. The extent of market exposure varies from one to another. This can be further related to the industry's growth prospect due to its attractiveness.

4.2.1.2 Industry's growth prospect

According to Porter (1985), five factors determine the attractiveness of the industry for long-term profitability. They are *the entry of new competitors, the threat of substitutes, the bargaining power of buyers, the bargaining power of suppliers, and the rivalry of the existing competitors*. In combination, these five competitive forces "determine the ability of firms in an industry to earn, on average, rates of return on investment in excess of the cost of capital

(Porter, 1985: 4). As a result, some industrial sectors grow faster than others.

In China, impressive economic growth has been achieved in the past two decades. However, industrial sectors grew at different paces and thus exhibited quite different growth prospects. This is so partly because not all industries offer their constituent firms equal opportunities for sustained growth under the transition context. Rather, new emerged industries grow faster than old ones. This can be illustrated in terms of employees and added values during 1995-97 (see Table 4.2).

Table 4.2. Number of employees and the value added (RMB 100 million), by industry, 1995-97

	1995		**1996**		**1997**	
	Employees (million)	Added values	Employees (million)	Added values	Employees (million)	Added Values
Medial & Pharmaceutical sector	1.02	264.67	1.02	359.93	1.01	411.51
Special Purpose Machinery sector	3.04	449.39	2.80	520.27	2.74	545.35
Electronic & Telecom sector	1.62	635.00	1.63	740.98	1.65	902.37

Source: SSB, 1998: 432. 1997: 424-425; 1996: 414-415

To a large extent, the three selected industrial sectors can be classified into three different growth groups: growing, declining, and restructuring. The growing sector is the electronic and telecom equipment manufacturing industry, where the added value and employment both expanded over the period of 1995-97. The declining sector is the machinery industry, where employment contracted, in spite of a moderate growth in values added. The pharmaceutical industry can be viewed as a restructuring sector, where added values increased significantly with a slight decline in employment. These different prospects for growth attract and push firms to exit and enter the industry, which would affect HRM and labour flexibility in companies.

When examined from the combination of the firm's total sales revenues and pretax profits by ownership, non-state firms seem more efficient than state firms in the three sectors, as compared to their respective small numbers of firm population in 1997 (see Table 4.3.). Two other indicators (i.e. labour productivity and average wage incomes of employees in the Table 4.3.) confirm some correlation between the higher labour productivity and higher average incomes and the higher returns on investment of non-state firms in industry.

It should be noted that a firm in a very attractive industry (such as pharmaceuticals) may still not earn attractive profits when it is entrenched by the old institutional constraints. Conversely, a firm distant from legacies may earn attractive profits in the declining industry that is not very profitable (such as the machinery industry). Some firms grow

faster than others, not only because of the attractiveness of the industry for long-term profitability, but also because of the embeddedness of the firm in the old industrial regime. In general, traditional industrial sectors such as machinery confronted declining market shares, while newly emerged industries such as the electronic and telecom sector is enjoying a dynamic growth prospect. Pharmaceutical industry is the sector where competition is intensified as the result of the entry of non-state firms that may induce state firms to move on to restructuring. Obviously, these different prospects for growth will affect the pace and scale of the entry of new firms, mainly non-state firms.

Table 4.3. Main indicators of industrial attractiveness, presence of firms, by ownership, in 1997

Industrial sector	No. of firms	Total sales revenues (100m)	Total pretax profits (100m)	Labour productivity (RMB/ person)	Average annual wages/ person (RMB)
Medical & Pharmaceutical sector	5028	1,177.58	149.15	35,557	5,933
SOEs	1,775 (35.30)	495.50 (42.08)	41.54 (27.85)	n.a.	6,008
Non-state firms	3,253 (64.70)	682.08 (57.92)	107.61 (72.15)	n.a.	n.a.
Of which: SFJVs	740 (14.71)	239.36 (20.33)	44.21 (29.64)	n.a.	8,376
Special purpose machinery sector	17,916	1,814.72	102.15	16,361	5,933
SOEs	3,797 (21.19)	797.29 (43.93)	18.50 (18.11)	n.a.	6,008
Non-state firms	14,119 (78.81)	1,017.43 (56.07)	83.65 (81.89)	n.a.	n.a.
Of which SFJVs	1,128 (6.30)	190.51 (10.50)	17.25 (16.89)	n.a.	8,376
Electronic & Telecom Equipment sector	7,345	3,681.30	314.71	47,844	12,056
SOEs	1,346 (18.33)	849.56 (23.08)	61.44 (19.52)	n.a.	12,065
Non-state firms	5,999 (81.67)	2,831.74 (76.92)	253.27 (80.48)	n.a.	n.a.
Of which SFJVs	2,570 (34.99)	2,300.63 (62.50)	199.50 (63.40)	n.a.	16,069

Source: SSB, 1998: 444-453; 456-457; 162.

Note: SFJVs, according to the Chinese official definition, include foreign involved equity joint ventures, cooperative enterprises, exclusively foreign invested enterprises, and enterprises funded by Hong Kong, Macao, and Taiwan (SSB, 1998: 444).

Briefly, the three chosen industrial sectors are open to market competition to different extents as the result of the entry of non-state firms in each industry. The different density of non-state firms in each industry can largely be attributed to the industry's growth prospects. Although the three industrial sectors differ greatly in terms of competition, and growth potentials (Porter, 1985), they share much in common in terms of being capital or knowledge intensive in nature. It is the difference, as well as the shared similarity, that renders flexibility of human resources crucial to successes (or failures) of firms competing in these sectors. As implied in the analytical framework, the three industrial sectors could represent different product market competition. To a lesser extent, these three distinct manufacturing sectors manifest themselves with different industry-suited technologies.

4.2.2 Two sites of investigation: Wuhan and Shenzhen

After selecting the three industrial sectors, sites of the fieldwork come to the forefront of the research design. To choose suitable sites for this empirical study, local labour market conditions and regulatory policy environments had to be taken into account. Eventually, the empirical research took place in Wuhan and Shenzhen[14], the two industrial cities, with one situated in the inland, and another in coastal south China, respectively. The two cities are representative of two considerations as shown in the analytical framework: 1) external labour market conditions; and 2) different regulatory and legal environments.

4.2.2.1 Local labour market conditions

Wuhan is the capital city of Hubei Province, situated in the developing middle economic belt of China. It has regular inhabitants of seven million, with three million living in the urban center area (see Table 4.4). The city sits astride both the Yangtze River and the Guangzhou-Beijing Railway, almost equidistant from Chongqing, Shanghai, Guanzhou (Canton), and Beijing. Traditionally, it was China's cross-roads being the "thoroughfare of nine provinces". The special geographic location of Wuhan induced the city to become a transport hub and a transshipment center in today's China.

Wuhan is also an old industrial center in the inland, where heavy industries predominated, such as steel, car, special machinery tools, and shipbuilding, all operating under state ownership in the past (Murray, 1994). As a result, a third of the city's SOEs operated in the

[14] Another reason for choosing the two cities for the investigation lies in the consideration of accessibility. Wuhan is the hometown of the author where he had been working for nine years and where he has been maintaining contacts with his colleagues, and friends. Shenzhen is a booming industrial city where the author has many good friends working in the government agencies and companies. Through common friends, a network was built up. This points to the importance of personal connections in China, which enables the author to gain access to the enterprises. However, the author's genuine identity as a PhD student abroad was undisclosed on the site of the interviews since the research question in the area of HRM remains quite sensitive in China.

red and many others on the borderline in 1997. Most of the loss-making SOEs are heavy industrial firms that came under radically restructuring through corporatization or merger in the 1990s. Other industrial firms, such as in pharmaceutical manufacturing and other hi-tech sectors, operated under great pressure of competition from non-state firms, although they grew relatively quickly in the late 1980s and prospered up to the present. The restructuring of SOEs led many workers to become redundant and subject to being layed off. In 1997, laid off workers in Wuhan alone cumulated to 300,000, 7 per cent of the local working population, according to local labour bureau officials interviewed. The local government faces increasing pressure to create more employment opportunities for locals. Employment pressure becomes further severe as migrant workers continue to flux in and substituted local low skilled workers. It was estimated that there were around 100,000 migrant workers employed in Wuhan in 1997 (by interview).

Table 4.4. Some basic indicators of Wuhan, in 1997

	Absolute number	**Percentage**
Population (million)	7.39	100.00
• Regular residents	7.09	95.94
• Migrants	0.30	4.06
Average age of population (years)	34.41	-
Labour force (million)	4.06	100.00
• Local labourers	3.85	94.83
• Migrant labourers	0.21	5.17
Annual average wage (¥/person)	5,981	-
Registered unemployed workers	0.33	8.1

Source: Wuhan Statistical Yearbook, 1998: 105-120, 124-134, 341-350.

Accordingly, new labour service agencies have been created to assist displaced workers in finding new jobs. For instance, local labour service centers and personnel exchange centers were set up under the leadership of the labour Bureau and Personnel Bureau in the 1990s. All the displaced workers from SOEs are required to register with centers for reemployment or retraining. The main mission of the city's experiment with "comprehensive urban reform" was to use its new power, delegated by the central and the province, to form the core of an economic region in central China. Moreover, it was hoped, "with its new independent powers, Wuhan should be able to reenact its historical role as a center of foreign trade, finance, banking, and information" (Solinger, 1993:175).

Shenzhen is a recently booming industrial city. It was best known as the original of four 'Special Economic Zones' – along with Zhuhai, Shantou and Xiamen – established as early as 1980 as the cutting edge of the economic reforms. Shenzhen[15] is adjacent to Hong Kong, situated in the south coastal area of Guangdong Province in south China. In 1980,

[15] The choosing Shenzhen as an experiment site lies in the advantage of confining any dangerous developments within defined geographical boundaries that would limit the risk of contagion (Howell, 1993).

Shenzhen was one of the poorest towns in the Guangdong Province, with a population of 30,000, almost entirely engaged in fishing. By 1997, Shenzhen has become a sprawling urban jungle of over three million people, with regular residents of 1.09 million, and migrant population of 2.7 million (see Table 4.5). It has an area that covers 200 square miles, gateway to Guandong Province. It is home of a good many of the country's millionaires, and with a per capita income more than seven times the national average (Murray, 1994).

Shenzhen was a pioneer in experimenting labour contract systems in SOEs in early 1980. The contractual labour system later spread into inland China in the mid-1980s. Since then, Shenzhen has led labour reforms in the country. Today, Shenzhen has become most flexible labour market in China, where millions of migrant labourers hunting jobs and got employed in newly created firms. It has established well-developed labour service systems and infrastructure, with a well-functioning labour exchange center and personnel exchange center. For instance, the Great Talented Exchange Center, created in 1996, offers daily personnel information that helps to meet the demands of thousands of job seekers and employers. Besides the Center, there are many local community labour service centers, regularly bulletining labour demand information. However, the booming of various development zones throughout China in the mid-1990, as indicated in chapter 2, poses challenges to Shenzhen as an investment capital flow hub. Despite relatively low labour costs in zones elsewhere, a large number of flux migrant workers continue flux in Shenzhen. This inflow of migrant workers, accompanying the establishment of new firms in Shenzhen, generates very conducive external labour market conditions for management to pursue labour flexibility in the firm.

Table 4.5. Some basic indicators of Shenzhen, in 1997

	Absolute number	**Percentage**
Population (million)	3.79	100.00
• Regular residents	1.09	28.76
• Migrants	2.70	71.24
Average age of population (years)	27.41	-
Labour force (million)	2.71	100.00
• Local labourers	0.78	28.78
• Migrant labourers	1.92	71.22
Annual average wage (¥/person)	18,381	-
Registered unemployed workers	0.015	2.46

Source: Shenzhen Statistical Yearbook, 1998: 518, 527, 532-33.

4.2.2.2 Variances of the business environment

As stated in chapter 1, China's incremental economic reforms started from agricultural sector to industrial sector, and from the coastal area to the inland. The 1980's industrial reforms were experimented in main heavy industry bases, such as Wuhan, across the

country (Murray, 1994), while cities in the coastal area such as Shenzhen moved much ahead of the inland in reform steps.

In most of the 1980s, Wuhan was selected by the central government as a pioneer in experiment with reforming urban industrial economy. In May 1984, Wuhan was granted economic management powers equal to those of a province, and received "separate line-item status" in the state plan. It was picked up again as one of the pilot cities for financial reform in early 1986, as the site for one of seven national steel markets in the beginning of 1987 (Solinger, 1993: 93, 175-6). Even in the early 1990s, Wuhan still stood in the forefront of the urban reform in the inland. When the late leader Deng Xiaoping made the famous south China tour in the Spring of 1992 to pick up the stagnate economic reform after the 1989 Tiananmen incident, he chose Wuhan as his first stop. A few months after the Deng visit, the city authorities announced two "New Economic and Technological Development Zones" in the urban suburban to attract private and foreign investment. However, as reform in other cities (such as Shanghai) moved faster after the mid-1990s, Wuhan seemingly lagged behind. Local authorities have been keen to encourage foreign interests to take over and introduce some much-needed management reforms. Today, Wuhan hosts several global industrial companies such as Philips and Japan's NEC that are all involved in separate fiber-optical cable ventures with Chinese state firms as partners. But the largest single investment project is the $ 1000 million required for the construction of a car manufacturing plat involving the French carmaker Peugeot. All these foreign invested joint ventures are located in the new Zones.

Shenzhen has since its establishment served as an experimental site for China's economic reforms and open door policy. It has been a pioneer in introducing many new reform policies into the rest of China, including labour contract system into SOEs (Howell, 1993). In effect, many reform measures experimented in Shenzhen later on spread to the inland areas. As a testing ground for reform, it has led the way with foreign trade volumes ranked first among all medium- and large- sized cities for seven successive year (People's Daily, Jan. 11, 2000). It also led the way in other key areas of reform. For instance, Shenzhen was a vanguard in lifting price control and abolishing mandatory production goals in 1984. Shenzhen pioneered the concept of letting SOEs go bankrupt if they failed to meet the criterion in management efficiency or market grade. The successful ones were authorized to adopt shareholding systems and even become limited liability companies listed on the local stock exchange. Only after Shenzhen demonstrated the success of the drastic reforms was the rest of the country allowed to follow suit (Murray, 1994). Moreover, Shenzhen served as one of the points where the Chinese economy intersects with the world economy and a window from which the world could peer at China's new market-driven economy. It has become China's main export and foreign-exchange earnings center, and a base for advanced technology, banking and finance. From 1992 onward, the total amount of exports by firms located in Shenzhen has been ranked as first among other Chinese cities.

From the policy environment or institutional perspective, Shenzhen has enjoyed a more favorable loose regulatory environment than Wuhan. Being designated as one of the Special Economic Zones (SEZs) in the early 1980s, Shenzhen was granted special privileges and higher autonomy in enacting a set of preferential business policies jealous by others. Many preferential policies were formulated and only applicable to foreign

investors in SEZs. For instance, the SEZ offered economic incentives such as enterprise income tax and other taxes possibly being waived or reduced for several years after profits begin; export taxes waived; import duties and some business taxes waived on a wide variety of imports needed to establish or operate an enterprise; land available on favourable terms; after-tax profits allowed to be repatriated without penalty; reduce welfare contributions to cut labour costs; raw materials and equipment available at preferential prices based on charges to SOEs.

The above preferential policies available in Shenzhen were out of the reach of firms situated in Wuhan until the late 1980s as New Technology and Development Zones were selectively set up in limited areas of the City. These preferential policies, coupled with its favourable geographical location enable Shenzhen to attract many foreign investors, private individuals, as well as other investment sources from the inland in search of more business opportunities.

To sum up, Wuhan and Shenzhen have shared some grounds in common but differ considerably in the policy environment. They were both pioneers in carrying out China's incremental reform, with the former serving as a testing site in the inland reform, and the latter as a testing site in the coastal area. However, the two cities were linked to different extents to industrial legacies of the past, and thus they face different institutional constraints or opportunities. In particular, some salient differences can be easily discerned in labour market conditions between Shenzhen and Wuhan. Shenzhen has relatively well functioning labour market and labour market infrastructure. This newly booming medium city has attracted migrant workers which more than double the number of the locals in size. Being a SEZ, firms located in Shenzhen enjoy more freedom in experimenting with various flexible labour reform measures. Firms located there take advantage of loose labour markets. Even very strict conditions (i.e. household registration) are imposed on migrant labour to SEZs (Ding et al, 1997), such a restrictive migration policy helps Shenzhen to selectively absorb highly qualified younger migrant labour from the inland while warding off low skilled workers. These differences in institutions and policy environments may have different impacts on employment relationships in firms, especially with respect to labour flexibility.

On the other hand, given the fact that Shenzhen has served as a reform experiment site, many new reform measures will continue being pioneered in Shenzhen, and subsequently spread to inland areas, including Wuhan (People's Daily, 1999). Hence, the success of the firm being flexibly managed in Shenzhen would have implications for their counterparts in Wuhan, at least from the managerial learning perspective. Yet, both the cities are changing rapidly, although at an uneven pace of transition, toward markets. In this sense, Shenzhen, by taking the first move advantage and enjoying more preferential policies, is now exhibiting a more dynamic economic prosperous prospect than Wuhan under the 1990s wave of reforms.

4.2.3 Identifying target firms: three working criteria

After choosing the three industrial sectors as a research setting, and the two cities as sites for fieldwork, the next step is to identify target firms. As implied in the analytical framework, the sample of the target firms situated in the two sites and coming from the sectors must meet certain requirements (e.g. divergences in terms of *ownership*, *age*, *core coalition* while sharing others in common). Accordingly, the following three criteria apply in identifying target firms in the fieldwork.

4.2.3.1 The ownership of the firm: nested governance

In economics, the boundaries of the firm are normally defined in terms of ownership (Hart, 1995). The ownership rights, according to Furubotn and Pejovich (1974), consists of (a) the right to use the asset, (b) the right to appropriate the returns from the asset and, (c) the right to change the asset's form and/or substance. The importance of property rights, according to Coase (1959: 14), lies in that "A private enterprise system cannot function unless property rights are created in resources, and when it is done,... chaos disappears; and so does the government except that a legal system to define property rights and to arbitrate disputes is, of course, necessary". In reality, to clearly define property rights is not only costly but also difficult (Williamson 1995). Kornai (1990) observes that market coordination conforms to the economy where private ownership prevails, whereas bureaucratic coordination conforms to state ownership dominating the economy. As such, some scholars pose a doubt on whether clear property rights really matter as a precondition for firms to grow in transition economies, where property rights are often complex and far from clear-cut (Walder, 1995; Putterman, 1995; Stark, 1995; 1997).

		State	
		-	**+**
Market	**-**	**Collectives**	**SOEs***
	+	**Private, and SFJVs****	

Figure 4.1. Governance of the firm: state versus market
Note: * SOEs --- State-Owned Enterprises
** SFJVs --- Sino-Foreign Joint Ventures

Despite ambiguity in property rights, industrial enterprises are still distinguished by ownership in today's China. At least in government statistical yearbooks, industrial firms

either take one of the three distinct forms of ownership: state-owned, collectives[16], and private (SSB, 1998: 431). Although the 1990s restructuring of SOEs into corporations has blurred the boundaries of different property rights in enterprises, the firm's ownership form, or governance still serve as a primary industrial anchor on which most of the government institutional constructs and policies are predicated (see Figure 4.1). This is what Kornai (1990) noted a strong affinity between ownership forms and coordination mechanisms. In other words, relevant government policies (constraints or opportunities) trickle down along the channel of ownership to govern constituent organizations. Consequently, different ownership forms convey different policy constraints or opportunities to management in the pursuit of labour flexibility in the firm. In order to look at the influence of the firm's ownership on HRM, both the state and non-state ownership of manufacturing firms should be selected as targets for investigation.

4.2.3.2 The age of the firm

As elaborated in chapter 3, the age of the organization implies inertia to adaptability in the lifecycle of growth since the organization form tends to be frozen at birth. In China, the age of the firm is linked to the history of the organization's growth trajectory, or the extent to which it is imbedded in institutions at large. Usually, old firms were either state-owned or collectives, with a close connection to the past socialism period, although some large SOEs have recently been transformed into jointly owned business entities in corporate governance (see chapter 2). Young firms are almost non-state owned, although some pure private firms register as collectives for the fear of the state appropriation (Putterman, 1995). Obviously, the age of the firm matters for HRM and labour flexibility. In identifying target firms for this study both young and old firms should be included, in addition to ownership.

4.2.3.3 The size of the firm

The size of firms is important for the study of HRM activities. Here, the size of the firm is referred as to the number of employees employed. Usually, the firm will not create the personnel department (by appointing personnel specialists), or trade unions offices, to deal with personnel issues until it grows to a large enough size (Buitendam, 1979). In China, the size of firms has been connected with their ownership and the extent of their integration into the planning system (Child, 1994). As stated above, large firms were generally state-owned, and had been evolved from the past state planning system. Small firms were never effectively integrated into the planning system and now coincide with the non-planned sector which today also includes many medium-sized and some large firms. Often, large firms not only need to establish enterprise-based trade unions and workers congresses, but also have Communist Party organizations, according to laws. The presence

[16] Big collective firms are governed in the manner that resembles more like SOEs, whereas small collectives resemble private firms. In some cases, private firms tend to register as collective firms in the fear of the state appropriation (Putterman, 1995).

of these personnel-related organizations has impacts on the firm's HR polices. In order to gain insight into HRM activities with respect to labour flexibility, state and non-state firms of a reasonable size should be chosen for an in-depth investigation.

To sum up, this case study research has no intention to obtain a random sample from each industry, covering the two cities. Instead, target manufacturing firms were chosen according to the above criteria: a) the widest possible range of ownership and management forms, with the overwhelming form of corporation and unusual variants; b) reasonable size and enough "history" for meaningful research and comparable analysis; c) different locations. The purpose is to keep the study scope manageable and to maximize comparability of firms located in two different cities.

4.2.4 The profile of selected sample firms

Ideally, as well as the initial intention in the design, different ownership forms of enterprises should be evenly present in the two cities and over the three industrial sectors. In practice, some identified firms in the particular form of ownership were missing due their lower prevalence in the industry (such as the case in the machinery industry), or denied access (such as the case of the telecom industry). In the end, ten manufacturing firms were selected from the three industrial sectors: two old state firms from the heavy machinery industry, two newly established non-state firms from the telecom manufacturing industry, and other six firms (state and non-state-owned) from the pharmaceutical industry (see Table 4.6).

Table 4. 6. Distribution of the selected firms, by ownership (1997)

	Corporatized SOEs	Private	Foreign invested equity joint venture	Total
Pharmaceutical	4	2	-	6
Machinery	2	-	-	2
Telecom	(Denied*)	1	1	2
Total	6	3	1	10

*Note: it was denied access with the reason of no interests in the study

In terms of location, seven firms were located in Wuhan, while the other three situated in Shenzhen. By the combination of both industry and location, four pharmaceutical firms were chosen from Wuhan, while the other two from Shenzhen. Wuhan is the site of the two selected SOEs in the machinery industry (see Table 4.7), due to the fact that Wuhan is an old industrial center in the inland where SOEs dominate. In contrast, Shenzhen houses newly emerged firms, and most of the newly created firms take the form of non-state ownership. In order to make a pair of cases in the telecom equipment industry, a private telecom firm was chosen from Shenzhen. However, such a paired case in private ownership is not available in the inland city of Wuhan. Instead, a Sino-foreigner telecom joint venture with the state participation was chosen from Wuhan. Just as SOEs in the

machinery industry is not available in Shenzhen. Here, both the location and the history of the city matter.

Table 4. 7. Distribution of the selected firms, by ownership and, by site (1997)

	Pharmaceutical		**Machinery**		**Telecom**	
	Corporatized SOEs	Non-state firms	Corporatized SOEs	Non-state firms	Corporatized SOEs	Non-state firms
Wuhan	3	1	2	-	-	1
Shenzhen	1	1	0	-	-	1
Total	4	2	2	-	-	2

In terms of age, the ten chosen firms exhibit a significant variance at birth (i.e. the year of establishment). This variance in the age of the firm is related to the history of the city where it situated, on the one hand, and the ownership it takes, on the other (see Table 4.8). In Shenzhen, most firms were founded only recently (mainly in 1980 or later) with less or no state stakes. They stand for the trend of new governance and management style. Conversely, old firms predominated in Wuhan, where newly established firms emerged recently, and few are purely private. Eventually, both the old and the new firms were included in the sample for the comparable study.

Table 4.8. A summary of the ten selected firms, by industry, location, ownership, and age

	Corporatized SOEs		**Non-state owned firms**		
Industrial sector	Shenzhen	Wuhan	Shenzhen	Wuhan	Total
Pharmaceutical	PhS-5 (1983)	PhW-1 (1939) PhW-2 (1955) PhW-3 (1582)	PhS-6 (1989)	PhW-4 (1994)	6
Telecom	-	-	TeleS-2 (1988)	TeleW-1 (1988)	2
Machinery	-	MW-1 (1959) MW-2 (1958)	-	-	2
Total number	1	5	2	2	10

Note: Figure in brackets denotes the year established

Table 4.8 is a summary of the ten selected firms included in this research. For convenience and simplicity, a code is assigned to each target firm instead of using the company name in

the analysis. The code indicates: whether the firm is in an industrial sector, pharmaceutical (Ph), machinery (M), telecom (Tele); whether it is located in Wuhan (W) or Shenzhen (S); and the number of the cases (1, 2, 3…). So, for example, the first of the pharmaceutical firm in Wuhan is coded PhW-1.

Together, ten firms chosen from the three industries form the setting of the empirical study. These chosen firms share much in common. For instance, they are all capital-intensive firms, with a strong knowledge base. They are also manufacturing companies that require higher skilled labour to effectively run sophisticated machines at the workplace. In case one criterion was not met in Wuhan, comparable firms in Shenzhen were selected instead. Within pharmaceutical manufacturing an attempt was made to ensure that all the chosen firms contained different ages and forms of ownership. The intention was to represent as wide a range as possible of such characteristics as size, age, external labour market conditions, technology, profitability, and scope of markets. These considerations, however, could be subordinated to the need to maximize variation in ownership and management style.

4.3 Data collection

Before the departure for the fieldwork[17] in China in the early 1998, the author made a number of contacts in advance with local research institutions and government agencies through email or mail by stating the purpose of the research and the scope of data collection. Such contacts relied on personal relationships that the researcher had built up and maintained beforehand. Usually, an additional confirmation of the acceptance for an investigation must be secured before the entry of the target firm in order to minimize any possibility of denial for access.

4.3.1 Period of investigation and the time span of data

An in-depth empirical investigation took place in Wuhan and Shenzhen, China, from February to June in 1998. Data collected during the fieldwork, unless stated otherwise, cover recent events up to the end of 1997. The reason for the time span is that a radical round of reform measures (i.e. corporatization, merger, acquisition, and bankruptcy of SOEs) was announced at the 15th Chinese Communist Party Congress in the fall of 1997.

[17] Before the author left for fieldwork in China, he asked the Education Section of the Chinese Embassy in the Netherlands to write a letter for his empirical research. The content of the letter is as follows: "*Yongping Chen is currently enrolled as a PhD student at Rotterdam School of Management of Erasmus University Rotterdam in the Netherlands. His research project is related to human resource management in manufacturing firms in China. He is going to collect empirical data in Wuhan and Shenzhen during the first half year of 1998. He also intends to contract relevant government departments and agencies. It would be highly appreciated if relevant Chinese organizations could provide necessary assistance and convenience to him in gaining access to target firms.*"

The Chinese reform trajectory in the field of management prior to 1995 was already well documented by most western scholars (e.g. Child, 1994; Warner, 1995; 1997), which offer some general trends to better understand the present. However, relatively little was known about recent management reforms after 1995. As radical changes occurred after 1995 the investigation focused on the recent period of 1996-1997.

The main data reported in this study derived from the empirical investigation of the ten selected firms from the three industrial sectors. The empirical investigation involved plant visits, interviews with, among others, senior executives, line managers, personnel specialists and trade union representatives. The topic contained in the research coincides with the latest phase of the enterprise reforms and the newly implemented downsizing of manpower in SOEs.

4.3.2 Collection of background information

Prior to inside-the-company interviews, the background information on the target firm, as well as government labour policies, was collected from the local and central government departments. There are four relevant government departments that were consulted: (1) the local Statistical Bureau, from which its industrial section is responsible for collecting and processing annual data reported by each enterprise; (2) the State or Provincial Economic System Restructuring Commission (central) or Office (local), that serves as the government think-tank on economic reform and open door policies; (3) the Ministry of Labour, and the Ministry of Personnel (central), or Labour Bureau, and Personnel Burean (local) responsible for labour policies to SOEs, or drafting labour laws; (4) the All-China Federations of Trade Unions (ACFTU), responsible for labour protection and employment terms that apply to different types of enterprises by industry.

In addition, other data sources on functions of local labour markets were consulted in newly emerged labour institutions: (a) the enterprise's Labour Service Corporation, dealing with the re-employment and training of laid off staff and workers; (b) the local Labour Services Markets or Talented Exchange Centre. The former offers a regular open labour market fair whereby job searchers at different skill levels and potential employers can meet directly and make employment deals. The latter facilitates the matching of supply of job searchers (mainly technical workers, and professionals) who want to leave current jobs, and the demand of employers. These documentary data sources together constitute an integral part of the database for the research.

4.3.3 Collection of data in the firm: Interviews

In-enterprise interviews were conducted with key informants, guided by an open-end structured schedule (see appendix III). The emphasis was placed on the workplace practices, as related to the firm's HR policy level status quo. The relative importance and priority of policy areas in HRM was highlighted from the management perspective. Interviewees include members of the senior and middle managers, and other key

informants, representing functional areas of management (such as personnel offices, finance offices, and production managers) or interest groups (such as trade union officials, and workers representatives). Each interview lasted from two to three hours on average.

To facilitate interviews in enterprises, case study protocol (see appendix III) was employed during the data collection process. These include background information on the focal firm (see above), main issues to be investigated, field procedures, persons to be interviewed, and interview protocols. Essentially, case study protocols describe the procedure of data gathering and registration, serving as a guide for the investigator to carry out the case study (Yin, 1994: 63). Such a guide would prompt relevant data collection in the appropriate format, and would reduce the possibility for a return visit. In addition, case studies protocols enable the investigator to concentrate on the main task in the field, reminding him of key issues during the interview.

Topics covered in interviews include: (a) procedures for new recruits and layoffs, (b) terms of labour contracts and enforcement, (c) reward systems and compensation practices, (d) fringe benefits, (d) job descriptions and job rotation, (e) internal promotion, (f) performance assessment, (g) skill/job matching and training programs, (h) labour turnover. Moreover, information was gathered about the enterprise characteristics such as: (a) types of product, applied technology, market share, (b) the size, composition, and change of employment volume (new recruits, layoffs, dismissals, and leaves), (c) compensation (wage systems, average earnings, and composition), (d) motivation (incentive systems, frequency of internal promotion, and the coverage of fringe benefits), and (e) training and education (such as, amount of training investment, number of trainees, categories of employees participating in training programs), as well as (f) performance indicators of the plant, such as, labour productivity, turnover of the sale, profits, and absenteeism.

The interviews were noted down in Chinese and then translated into English. Request for recording interviews by a recorder was often denied in most cases, and such a request proved a barrier on the subsequent interview's interactions and information exposure. Sometimes, a scheduled interview was interrupted or canceled by the sudden departure of the manager due to urgent calls to duty. Therefore, new interviews had to be arranged. If target interviewees were not available after several requests, other informants were sought in the same enterprise. The resulting interview data were combined with the secondary information gathered from annual reports, company brochures, newspapers, and even Internet. In the end, a case study report on each firm investigated was written, and sent to the respondents with a request for the comments and the correction. Most of the feedback received from the investigated companies requested minor adjustments, except for two companies that responded with requests for a withdrawal from the investigation because exposed data were perceived as sensitive or adverse. These two companies were not included in the data set of the research.

In-depth interviews constitute a main source of research data. More than forty separate meetings were held inside the firm. An enormous amount of useful messages, qualitative, and quantitative, were gathered on informal occasions, mainly dinners outside the firm. The nearly twenty meetings with local relevant supervising agencies also provided useful information, as did the interviews with scholars in local research institutions. In the end, all

these data sources can be utilized to paint reasonably clear pictures of the operations, institutional changes, and environment of the investigated enterprises in the two cities.

In short, this empirical research required considerable in-depth fieldwork that had to be accomplished in a relatively short time and with limited resources. The two sites selected enable the author to arrange comprehensive fieldwork to take place in the target firm for data collection. Unlike much other empirical research in the field, all the selected firms included in this study were visited by the researcher himself, instead of through third parties, or translators. This research did not use a postal questionnaire but relied on a semi-structured interview schedule on each site.

4.4 Characteristics of the investigated firms

This section provides an overview of the firms investigated during the empirical study in the ten selected firms. A description of the ten investigated firms was summarized in appendix 1. Some of the data will be presented in detail in the subsequent chapters of the empirical analysis. In what follows, the main characteristics of the ten investigated firms are summarized.

The ten firms investigated are relatively large-sized manufacturing companies in China. They employed workers ranging from 398 to 7441 in 1997 (see Table 4.9). The large firms were generally state-owned. One exception is TeleS-2, a private telecom firm located in Shenzhen that grew from 6 persons in 1988 to as large as of 5600 workers by 1997 (see appendix 1). By and large, the two machine firms included in the sample (i.e. MW-1 and MW-2) stand on the highest end of the employment scale. On the opposite side is the TeleW-1, a Sino-foreign joint venture employing 398 workers. The two other selected private firms are quite large in terms of employment, as well as by any other standards of comparison (see Table 4.9)

Each selected firm has a personnel department (in state firms) or human resource department (in non-state firms), employing four to eight specialists dealing with personnel issues. Company-based trade unions (even workers congresses in the case of MW-2,) are present in all the selected state firms while they are absent in the two private firms included in the study. However, the Communist Party office is established in all investigated firms (including the two selected private firms and an SFJV). This points to attempts of powerful Party organizations to maintain influence on all business entities in China.

In terms of business scope, all the ten selected firms focus on a single business in one industry, while some pharmaceutical firms (e.g. PhS-5, PhS-6, PhW-4, and PhW-2) attempt, although very naïvely, to move toward the diversification of their business scope (see appendix 1). This can be observed from their product scope that all the firms produced in 1997. An attempt to diversify the business scope in Pharmaceuticals may be more attributed to the extent of industrial competition rather than to the firm's location. However, the diversification of business scope may indicate the management's efforts to spread the firm's risk of the over-concentration on one industry, especially in a declining

industry, such as the case of the MW-2 in the machinery industry.

Table 4.9. Characteristics of the ten investigated firms: main indicators, in 1997

Firms	Employees (in person)	Main products	Sales revenue (in ¥ million)	Pre-tax profit (in ¥million)	Personnel-related internal organization
PhW-1 (SOE)	3100	Western & Chinese drugs	300	44.5	Personnel dept. TU, Party office
PhW-2 (SOE)	900	Chinese drugs	300	54	Personnel dept. TU, Party office
PhW-3 (SOE)	800	Traditional Chinese drugs	80.2	30.2	Personnel dept. TU, Party office
PhW-4* (Private)	980	Chinese healthy drinks	1500	460	Human resource dept. Party office
PhS-5* (SOE)	500	Western & Chinese drugs	260	10	Human resource dept. TU, Party office
PhS-6 * (Private)	488	Western & Chinese drugs	600	85	Human resource dept. Party office
MW-1 (SOE)	6100	Industrial boilers	680	30	Personnel dept. TU, Party office
MW-2 (SOE)	7441	Heavy machine tools, lathes, bores, millers	104.4	-17.14	Personnel dept. TU, workers congress Party office
TeleW-1* (SFJV)	398	Optical fiber and cables	880	90	Human resource dept. TU, Party office
TeleS-2 (Private)	5600	Telecom equipment and exchanges	4,100	190	Human resource dept. Party office

Note: ¥= Chinese currency unit Renminbi (RMB) yuan (1US$=¥8.09); TU= Trade unions at the company level.
*With the participation of foreign investors, claimed by the firm when investigated.

In terms of profits, except for the two machine firms that suffer low profitability as indicated by profits relative to revenues, all other firms investigated have been profitable, and are growing in sales and markets, although the pace of growth and the extent of profitability vary from firm to firm (see Table 4.9). Specifically, the two investigated telecom firms exhibit higher profitability than their counterparts in the pharmaceutical sector. This implies that private firms grew much faster with higher profitability than their state counterparts. The pace of growth and profitability is coincident with the age of firms'

establishment in that younger firms have more dynamic prospects for growth. Usually, slowly growing firms are those old firms that were inevitably locked into the state ownership long before their move to corporatization in the 1990s. In this sense, the age of the firm really matters in organizational changes (either inertia or continuity). The firm's age is obviously closely linked with the firm's broad institution environment that shaped the firm's past and will remain vital for its future transformation.

To sum up, the ten selected firms differ in the age of their establishment, ownership, and location. Three firms situated in the coastal city of Shenzhen Special Economic Zone were selected from two industrial sectors, which signifies special policy environments and different labour market conditions. In the inland city of Wuhan, seven firms were chosen from the three industrial sectors. Firms located in Shenzhen are relatively young, but not necessarily private in ownership (e.g. PhS-5). Conversely, five firms situated in Wuhan included in the sample are coincident state-owned old firms. However, two recently established firms in Wuhan were also included (i.e.PhW-4, and TeleW-1), with each taking either private ownership, or foreigner-invested joint venture with the state participation. These are new entrants into the two different growing industries after economic reforms. In the declining machinery industry, large state firms continue to dominate, and private firms shun entry.

4.5 Data evaluation: validity and reliability

The data collected for this research came mainly from case studies in the ten manufacturing firms, with special attention to labour flexibility at the workplace. As stated in the beginning of the chapter, this case study research is not intended for a statistic generalization. Rather it aims to use the well-developed theoretical perspectives or tools in the Western literature to explore and explain workplace practice phenomena in companies under China's transition context. What follows is to briefly discuss validity and reliability of data collected through the case study research.

Case study research is frequently applied, but also often criticized, particularly with respect to validity and reliability. The vulnerability of case study research to criticism lies in the construct validity to be secured from multiple sources of data collection. This means that complex phenomena under observation in the area of HRM must be translated into measurable indicators. As pointed out in chapter 3, the concept of labour flexibility has different dimensions, which can be translated into various measurable forms and types for observation. In this research, case studies were carried out mainly through interviews with informants, using some of these forms, and guided by semi-structured questionnaire for data collection. Besides the case research method, other complementary research methods such as document analysis, and participatory observations were also applied in data collection. In addition, the firm's background information was collected through external labour agencies and government institutions. The multiple sources of data collection maintain a certain level of validity.

Reliability refers to the extent to which repeatedly applying the designed procedures for data collection leads to the same result (Yin, 1994: 32-33). Reliability relies on the

measurability of the variables employed in the observation, which represents the precision and independence of investigator and data source. To ensure maximum reliability of the information gathered, the researcher himself alone administered all the interviews in enterprises chosen, without hiring any assistant during the fieldwork period. Meanwhile, a case study protocol was used over the entire period of fieldwork. Interviews were held with the firm's managers (most of time, the personnel manager), and/or with local relevant supervising institutions. Responses were double-checked, the first check followed immediately after the interview during the day time, then the second check was made in the evening of writing an interview report on each firm. All missing data were detected in the field, and inconsistency in responses was eliminated by a request for a follow-up interview or through a phone call for clarification. By so doing, reliability of the case study findings was maintained to a great extent.

Although this case study research investigated the ten manufacturing firms chosen from the three industrial sectors with diversified forms of ownership, two limitations of data collected should be indicated here. First, a sample of the studied firms chosen from each industrial sector is not paired in number and ownership. Impaired sample cases under the investigation may undermine the author's effort to make an in-depth comparative analysis. However, this limitation is largely offset by six paired-cases selected from the pharmaceutical industry.

Second, and related to the first, the selection of the interviewed respondents was restricted to functional managers, and trade union leaders in the firms studied, without further reference to and generating information from the rank and the file. This company key-informant orientation may have created a management-induced bias with respect to advantages and disadvantages of flexible working practices adopted at the workplace. To some extent, the anticipated bias in data provided by powerful stakeholders in the firm was reduced to an acceptable level through additional information collected from relevant government agencies outside the firm, as indicated above. The following chapters will provide an analysis of the empirical data.

Chapter Five

Labour Flexibility at the Workplace: Empirical Findings I

Introduction

This chapter presents empirical findings on flexible working practices that have penetrated the workplace. The empirical data were collected through case studies of eight high-tech firms that were selected from pharmaceutical and telecoms industries, the two most lucrative sectors with huge market potential in China (see chapter 4). The purpose of the research is to examine what kind of labour flexibility is pursued in the firm by management, and to what extent it is achieved at the workplace in realizing certain business objectives.

By referring to Western analytical tools as reviewed in chapter 3, forms of flexible working practices adopted in the investigated firms are identified and adjusted according to China's context, and aligned along functional and numerical dimensions (part I). Then, details about how these identified flexible work practices are actually applied to the workforce at the workplace are presented separately (part II, and part III). This is followed by a discussion and evaluation of the empirical findings as documented from case studies (part IV). Conclusions are at the end of the chapter.

5.1 Labour flexibility in China's context: types and forms

As noted in chapter 3, the rise of labour flexibility in the West concurred with a shift in competition locus from one based on price and quality of the 1980s, to one based on the combination of product price, quality, and flexibility in the 90s (Bolwijn and Kumpe, 1990; Volberda 1998). Along with the shift in the competition focus has been a move away from "Taylorist" mass-production, and bureaucratic control of employees, towards more flexible forms of work organization based on "flexible specialization" (Piore and Sabel, 1984). The success of the Japanese "lean production" and "just-in-time" system throughout the 1980s to the mid-1990s provided striking evidence for the importance of innovative work organization methods (Osterman, 1994b). These developments mark the declining popularity of the conventional "Fordist" production methods, and signal the advent of flexible work organization practices (OECD, 1999).

The central features of the flexible work organization are flexible production, small batch production, labour contingency, and vertical integration (Kundsen and Boggs, 1996). These changes have altered the way work is organized, and the way in which labour and technology interact (Bosworth, 1996; Woodward, 1958). Flexible production needs skilled and flexible workers. Workers must be sufficiently educated and trained to perform multi-skilled jobs on an ever-changing mix of customized products (Beatson, 1995). Technological advance also raises the required level of both analytical and the behavioural skills necessary to perform a job (Bolwijn and Kumpe, 1990). In particular, the use of new information technology promotes the integration and coordination of activities between and across different function departments of the organization (Pfeffer, 1999). Increasingly, the firm's competitiveness lies mainly in innovative product supply, and niche market responsiveness, rather than pure price-effectiveness, and standardized mass-market services (Kundsen and Boggs, 1996). This tends to favour a flatter organizational structure, with considerable emphasis on lateral work and communication (OECD, 1999: 180).

In China, labour flexibility rose to prominence in the mid-1980s as the government attempted to eliminate employment rigidity that prevailed in the state sector (see chapter 2). Initially, flexible labour practices emerged in foreigner-invested joint ventures concentrated in South China that delivered higher labour productivity and responsiveness to market changes (Howell, 1993). Subsequently, advantages of flexible employment relationships in foreigner-invested joint ventures and other non-state firms posed a great challenge to employment rigidity in the state sector under the new business environment (White, 1982; 1987b). Labour reforms that started in the mid-1980s have further enhanced enterprise managers' autonomy in the use of labour in a flexible manner. To date, various flexible working practices are emerging in both state and non-state firms. Although employment relationships remain relatively secure in the state sector (as compared to western economies), the move toward labour flexibility is steady and irreversible as market competition intensifies in today's China.

As noted in chapter 2, and chapter 3, a fundamental feature of China's labour market is the co-existence of excess supply of unskilled labour and relatively scarce skilled labour. For unskilled labour that exhibits high market substitutability, managers and firms need to find ways to flexibly use it as much cost effective as possible in order to achieve higher productivity and responsiveness. For skilled labour that has a limited supply in labour markets, management needs to find ways to keep skilled workers as the core of the workforce for a long commitment. The firm's workforce is therefore segmented into the core and the peripheral that can be distinguished by employees' job positions and skills.

By applying the Western concept of flexibility as discussed in chapter 3, we cluster flexible working practices collected from the eight firms studied along two dimensions of flexibility, with the emphasis on the internal dimension of labour flexibility (see Table 5.1). The reason for the focus on internal flexibility is that most of the firms studied attempt to increase labour flexibility among regular employees (with formal contracts). Only a small fraction of tasks is contracted to external labour (such as temps, and migrant workers, as will be shown later in the chapter). Accordingly, four flexible practices (i.e. flexible working time, lay-offs, quits, and dismissing and firing) constitute internal numerical flexibility. The use of temporary workers is added as an external form of

numerical flexibility as assumed in the literature. Likewise, internal functional flexibility includes teamwork, job rotation, job enlargement, and job enrichment, while contracting out is regarded as external functional flexibility.

Table 5.1. Forms and types of flexibility in China's context

	Numerical	Functional
Internal	• Flexible working time • Laying off (collective) • Job quitting • Dismissing	• Teamwork • Job rotation • Job enlargement • Job enrichment
External	• Temporary workers	• Outsourcing

As compared to conventional forms of flexibility prevailing in the West, laying-off, quitting, and dismissing[18] are regarded as flexibility practices in this study. The inclusion of personnel turnover into numerical flexibility in China's firms is grounded upon the country's context evolving from the past. First, these personnel phenomena rose recently in China's firms, and they are relatively new to Chinese managers. In the past, Chinese managers were never allowed to use such personnel practices to manage workers in state companies. Second and, most significantly, most Chinese managers, as will be shown, now employ these practices to realize certain managerial objectives, rather than mere adjustments in labour relations. Thirdly, concerned actors attach quite different meanings to these practices. The layoff policy, for instance, ever perceived as a typical capitalist personnel practice in the West, is now adopted by China's state firms engaging in downsizing as a collectively head-cutting action against redundant workers. Job quitting, and to a less extent, dismissing, may be manipulated by management to get rid of undesired employees on the individual base. While the job quitting may be in the guile of workers' individual choices, the latter is an outright managerial 'carrot and stick' policy. Apparently, the managerial use of labour turnover practices shall have significant impact on management's ability to adjust the size of workforce to changes in the product market. It also marks a sharp break with the past 'iron rice-bowl' employment system in the state sector.

The following analysis will shed light on how these identified flexible working practices are actually implemented at the workplace. The purpose is to examine to what extent the adopted flexible working practices are related to management's response to market pressure under the changing business environment.

5.2 Numerical flexibility: cost-based flexible working practices

By referring to the concepts reviewed in chapter 3, numerical flexibility is a cost-based employment strategy that can be approached both internally and externally. Table 5.2

[18] The aggregate of laying-off, quitting, and dismissing and firing is indicative of labour turnover that is usually not included in numerical flexibility in Western companies.

summarizes various numerical flexible working practices collected from six studied pharmaceutical firms and two telecoms firms, using the case study method (see chapter 4). It is clearly shown that each firm studied adopts flexible work practices in different ways, to a different extent, and with different emphases. Eventually, the combination of numerical flexible practices documented from each firm constitutes a flexibility profile that varies with firms and between the two industrial sectors.

Table 5.2. Summary: Profile of numerical flexibility practices in the eight firms studied, in 1997

Forms of numerical flexibility practices	PhW-1 (SOE)	PhW-2 (SOE)	PhW-3 (SOE)	PhW-4 (Priv*.)	PhS-5 (SOE*)	PhS-6 (Priv*)	TeleW-1 (Jovt*)	TeleS-2 (Priv.)
1. Flexible working time								
• Work shift (>1)	-	2	+	3	3	2 – 3	3+	-
• Overtime working	-	+	+	+	+	+	+	+
• Part-time working	+	+	+	+	+	+	-	-
2. Laying off	400	10	40	-	-	-	-	-
3. Job quitting (voluntarily or forced, on the individual base)	Low 2% or (60)	Low 0.1% or (1)	Low 0.25% or (2)	High 20% or (100)	High 30% or (150)	High 10% or (50)	Low 2.5% or (10)	Low 4% or (224)
4. Dismissing and firing	8	3	2	10	10	17	2	-
5. Use of temporary workers	+	+	+	+ (15,000)	+	+	+ (44)	+ (200)

Note: "+" = present " – " = absent. Figures in the cells indicate the relevant number of incidences occurred in 1997. "*" denotes the presence of foreign investors.

The following section will examine in detail how these flexible practices are actually implemented at the workplace, and which segment of the workforce is expected to deliver numerical flexibility. The purpose is to see how these flexible practices are related to the cost-based employment strategy as assumed in chapter 3, and whether there is a difference between the empirical findings of this research and what was observed in the West.

5.2.1 Flexible working time

Here, flexible working time practices include *work shift*, *overtime working*, and *part-time working*. At first sight, these flexible working time practices can offer benefits to employees since they are able to flexibly schedule their work hours to meet their personal demands. From the management perspective, application of these practices can have a motivating effect, because they tend to reduce absenteeism, improve morale, and improve worker productivity (Lazear, 1998). On the other hand, flexible working time practices can have drawbacks for managers to direct subordinates outside the common core hours. In particular, these practices are likely to cause confusion in shift work, and to make work planning and controlling more cumbersome and costly (Robbins and Coulter, 1999). What follows is how these practices are applied in the eight firms in China.

Work shift

Work shift is a common work organization method used to keep work running in a continuous manner. The necessity to use work shift derives from the continuous production process that requires workers stand by to maintain machines along the production lines. Work shift is not new in China. It was ever present at the workplace of the state firm as a means to fulfill production quota under the command economy (Walder, 1986). In the eight firms studied, the use of work shift is increasingly linked to management's response to product market changes.

In the pharmaceutical sector, all the firms, except for PhW-1, adopt regular or irregular (in the case of PhW-3) work shifts. No shift work in PhW-1 lies in the fact that this old state firm has excess production capacity that makes such shift work superfluous or unnecessary. In fact, PhW-1 needs to downsize its excessive number of employees as a result of shrinking market shares in the 1990s (see the case study PhW-1).

> **Case study PhW-1: Work shift is absent due to excess production capacity**
> There is no work shift in practice in the company. Workers and staff follow normal work time and normal working days in accordance with the Labour Law. The reason for the regular working time arrangements is that the company has an excess production capacity relative to market demands for its products due to intensified competition. The problem of excess production capacity is further worsened by a declining profit margin of the products the company could maintain. In other words, the company has to restrict its production capacity in the light of market changes. Otherwise, the more the company produces, the more unsold products, and the more the loss incurred. As acknowledged by the manager interviewed, the company is now in bad need of downsizing. In other words, work shift is of no economic use in the company just as it is used otherwise in other companies.

In the other firms studied with work shift practice, the number of work shift incidents is highly dependent on product market changes that the firms face. Moreover, work shift is more often applied in production plants among first line workers, rather than other categories of employees (such as managerial and technical employees).

> **Case study PhS-5: Work shift applies in plants that are contingent on markets**
> Three work shifts are under practice in production plants. The work shift arrangement stems partly from the requirement of the continuous production processes in the pharmaceutical manufacturing. In raw material preparation plants, for instance, three work shifts take a turn to monitor processing 24 hours per day, whereas the necessity of three shifts in the rest plants depends on the production need dictated by markets. When there is a sudden rise in demand, three work shifts apply in all plants, and workers are organized in shifts. However, as a slump in

> demand leads to fewer shifts, even less working time applies accordingly. Hence, a number of work shifts practiced in plants reflect both the requirement of production processing and fluctuations of market demands for products.
> Usually, as work shifts are practiced in plants, necessary technical or managerial supports are expected from technical and managerial staff, which may need overtime working accordingly. The rest managerial staff work five days per week, and are seldom required to take overtime working. However, workers on work shift don't enjoy a higher wage rate than a normal one.

It should be noted that technologies applied in the six studied pharmaceutical firms do not exert significant impacts on work shift arrangements. This is so because in all the six studied pharmaceutical firms, applied medical production processing technologies are quite identical in terms of automation, mechanization, and sophistication in complexity. The homogenous nature of the applied technologies stems primarily from the similar production processes among these firms producing a clutch of almost identical medical products (i.e. traditional Chinese medicines). For instance, of the six investigated firms, three of them (PhW-3, PhW-4, and PhS-6) claim to apply the international standard (GMP[19]) in their production processes, and where shift work arrangements apply.

The frequency of work shift varies, however, from one on the irregular base (in the case of PhW-3) to two to three on a regular base (in the case of PhW-4 and PhS-6). The same number of shift work is reported in other two firms that have not adopted the GPM but had two to three shifts (i.e. PhW-2, and PhW-4). Obviously, work shifts depend much on the need of production, which is, in turn, associated with changing product market demands.

A sharp contrast is observed between the two telecoms firms studied in the use of work shift. The telecoms firm of TeleW-1 (i.e. foreigner involved joint venture) has three work shifts under practice at plants, while TeleS-2 (i.e. private owned firm) does not have any shift work at all. The three-work shift arrangement in TeleW-1 lies in the requirement of applied production technology that entails a continuous operation. However, behind the three-work shift arrangement is a cost-effectiveness consideration as publicly acknowledged by management during the interview. "We cannot afford to keep our clients waiting for our products. Otherwise, lost markets will not be won back easily without excessive cost commitment, given intense competition in telecom markets."

> **Case study TeleW-1: Three work shifts to keep production lines running**
> The company has a couple of production lines installed at two plants that keep running 24 hours a day. Three work shifts apply on each production line, with each shift taking a turn in every eight hours and another extra shift standing by. Work shifts require workers to be punctual, and make a good work conjuncture in the time of shift change. Since the production

[19] GMP: refers to 'good manufacturing practices', a standard for pharmaceutical manufacturing set out in the US in 1964.

> lines are highly automated and technological intensive, with two workers needed to run the entire production line. Production workers are required to be working in a cooperative manner. There is not distinctive divide between the tasks of each employee.

The reason for no-work shift practice in TeleS-2 is the fact that the majority of the workforce in this high-tech telecom company involves overwhelmingly research & development, marketing and sales services, with a small fraction of the workforce working on production lines (see appendix 1). This was reflected in the occupational composition of the employees that 40 per cent of the workforce was highly educated technical employees engaging in R & D (or 2200 out of the total 5600 employees) in 1997. The second largest cluster of the employees involved in marketing and sales services (35 per cent). Only 13 per cent of employees were production workers engaged in the core telecom component manufacturing, while the remaining production activities were contracted out, or relied on markets for supply.

> **Case study TeleS-2: Keeping the core activities inside while contracting out the rest**
> The company only keeps a few production plants that manufacture core part of telecoms equipment. The remaining production activities are contracted out or relied on markets for supply. In the production plants, line production features production processes at the workplace, with the high level of automation and mechanization. Most processing equipment is imported from abroad. This high level of automation needs few employees working on the line.

In short, the use of work shift is increasingly linked to the need of production of the firms studied competing on the same product market. The number of work shift under practice, however, is associated with the firm's applied technologies, the mode of production, or the combination of the both. All are eventually contingent on product market changes. No significant difference is found between the two industrial sectors in the use of work shift among the firms studied.

Overtime and part-time working

Overtime working and *part-time working* is under widespread practice among almost all the investigated firms included in this study. One exception is the case of PhW-1, again, where overtime working is absent while part-time working is present. This is in contrast with the studied two telecoms firms (i.e. TeleW-1 and TeleS-2), where overtime working is frequently sought while part-time working is absent (as will be explained below). The reason for no overtime working in PhW-1, just like the absence of work shift in the company, lies in the fact that this state-owned company suffers from excess production capacity that renders overtime-working arrangements uneconomically. In fact, excess employees in this firm need to be laid off.

The growing use of part-time and overtime working practices among the studied

pharmaceutical firms stems from the advantages of these two flexible working arrangements over work shift. First, part-time and overtime working can be used alternately on an irregular base to meet to the need of production fluctuations deriving from pharmaceutical market changes. Second, overtime and part-time working practices, as the case PhW-2 will be shown below, are often applicable to all the employees including managerial personnel, for similar reasons and in the same manner.

Case study PhW-2: Overtime and part-time are contingent on product markets

Often extra working hours or even working days are required of all the employees including managerial and technical personnel. This is most likely so during a production peak when product orders suddenly increase within a limited time. Workers are happy to take extra working hours and days. Because extra working time implies extra incomes at a higher rate of payment than the normal rate set out by the *labour law*. But the company normally does not pay a higher rate to employees for their extra work time. Instead, bonus payments are offered. Even if the expected extra payments cannot be realised for extra working time, no overworking employee insists on extra compensation or dare to be absent. In the words of the personnel manager interviewed: *"That is a natural thing. Who knows markets will pay off your extra work. There are many unexpected elements in product markets. Our salesmen struggle to get more market orders. The orders must be met in time and in quality. As a worker, his duty is to fulfil production quota assigned to him. We are on the same boat; no body else could rescue us. We have to take care of ourselves. We are masters of the company."*

As opposed to overtime working, part time working occurs when product markets meet a downturn. In such circumstances, management usually reacts with reducing workers normal working hours, or downsizing employees. Some workers are asked to work part time, while others become *idle workers* staying at home and waiting for production tasks. For the latter, wage payments will be reduced proportionally but still maintain to the level higher than basic living expenses received by layoffs from the company.

It should be noted that the use of part-time and overtime working practices goes increasingly, but not always, with flexible rewards in terms of monthly bonus payments that links individuals' performance. Moreover, overtime-working arrangements do not always accord with legal regulations governing both the overtime working and the compensation as set out in the Labour Law. This is especially true in PhW-4, and PhS-6.

Case study PhW-4: Overtime working without any pay

Overtime working in the company takes six days per week, one day more than legally set, and more than eight working hours per day. When asked why one day more than the enacted, the interviewed personnel manager answered that actual working hours per week in the company do not essentially exceed 40 hours if excluded two hours for lunch per day. As

> far as more working hours per day are concerned, managers argued that this is not mandated in the company, but stemming from employees themselves' failure to fulfill assigned work within eight hours per day. Hence, there is no extra payment for extra working time, not alone pay at a higher wage rate, as required by the Labour Law.
>
> **Case study PhS-6: Overtime working is contingent on the need of production**
> Two work shifts are under practices in plants, if needed, three shifts are applied to some job positions. Production workers work five days a week, but overtime working is demanded during a production peak when two shift work could not get production tasks finished during normal working time. Overtime working is also required of managerial and technical personnel when production workers work overtime. However, overtime working does not always mean an extra payment to employees at a higher rate set out by the Labour Law.

The above two firms studied do need overtime work from their employees but waive to pay as assumed. These two private firms included in the study, however, has very high profits (see chapter 4). Obviously, management intends to save costs while putting more workload on workers who have to overwork.

A cross-industry comparison of overtime and part-time working practices reveals that the two telecoms firms studied take use of overtime work extensively while leave part-time working out. This is in sharp contrast with most studied pharmaceutical firms where these two flexible working time practices exist. For instance, overtime working in TeleW-1 takes six days per week, occasionally more working hours per day during a production perk, whereas in TeleS-2, five and a half days per week apply to all employees on a regular base.

Another salient difference is that in the two telecoms firms, overtime working may not directly be linked to the goal of extra payments alone. In TeleS-2, for instance, overtime working is motivated as much by attractive stock options as by the sense of employees' self-actualization (see case study TeleS-2). Eventually, the availability of rewards (in cash and kind) for extra working time differentiates the two telecoms firms studied from most pharmaceutical firms in the study.

> **Case study TeleS-2: Over time working not merely for money**
> Over-time working frequently occurs in the company out of the employees' own wills. When asking a project manager of why they voluntarily take overtime working, she said that: "The company wants just-in-time working, and just-in-time off working every day. We have to be punctual every day *on* work, as well as *off* work. This is a rule not to be violated by any one in the company. We must be punctual off working at 5:30pm, and then come back to office continuing work left. We do so simply because we are enjoying our work. We feel exciting in meeting such challenges in our high-tech project that will bring us more achievements than just stay idle at home watching TV or chatting.

> Nobody on our team wants to waste of his valuable time. If we succeed in the project, we have rights to put our names on patents although the property right of the patents is owned by the company. We will have more stock options, more chances for pay raise, and promotion. In short, we will have a strong sense of self-actualization, as well as self-achievement. These goals become what we are pursuing and are encouraged through our corporate culture."

The above empirical findings clearly show that the three flexible working time practices are sought mainly among full-time regular employees working in the first line, rather than among contingent employees hired additionally as is the case in the West (Steenbakkers, 1994). The growing use of flexible working time practices, however, does not pose difficulties to management in scheduling the working time of employees to meet production demand. On the contrary, these flexible working practices enable the firm to adjust the labour inputs of the existing workforce to the requirements of production in light of market changes. In two private pharmaceutical firms (i.e. PhW-4, and PhS-6), the three flexible working time practices are subject to management discretion, with little due attention to meeting employee personal demands.

Apparently, the use of three flexible working time practices is increasingly linked to the need of production, and based mainly on the cost-cutting consideration. Of the three flexible working time practices, the frequency of using work shift is largely contingent on product markets, and to a less extent, is determined by requirements of production processing technologies applied. Comparatively, two other forms of flexible working practices (i.e. overtime and part-time working) are under wider practice than work shift among regular employees in all the firms investigated. In particular, the alternate use of overtime and part-time working is dictated by management in response to fluctuations of production to market changes.

The empirical evidence also reveals that non-state firms tend to make intensive use of overtime and part-time working arrangements more than state firms do. This points to the weakness in legal and institutional regulations against the abuse of flexible working hours in non-state firms that is far from the reality. A cross industry comparison shows that the two telecom firms studied are more likely to use overtime practices vis-à-vis part-time working practice than the pharmaceutical firms investigated, largely due to the difference in rewards. In particular, the use of flexible working time practices is increasingly linked to flexible rewarding practices, a theme that will be picked up in the next chapter.

5.2.2 Laying-off

In Western economies, *layoff* usually refers to the suspension of labour contracts whereby employment relationship is terminated between employees and the company on a large scale. In Cameron's (1994) work, layoffs are one of the three downsizing strategies taken by top management in its attempt to minimize labour costs, and to increase flexibility and adaptability. In essence, layoff is a typical capitalist practice to shift economic crises onto workers, rather than merely as a means of labour adjustment. Hence, downsizing can have

a substantial negative effect on employees' morale and attitude in organizations that emphasize creativity (Pfeffer, 1999). In particular, cross-the-board layoffs may not push the least able employees to leave. Instead, some downsizing programs unwittingly encourage the more able and valuable employees to depart (Baron and Kreps, 1999;).

In China, layoff came to fashion only recently when the government abandoned the full employment policy, and adopted as a new approach to revamping redundant workers in SOEs in 1997 (for details, see chapter 7). Even so, the term layoff in China is politically redefined with specific meanings. And Chinese managers tend to deliberately avoid using the term lay off in their daily management.

> Factory managers have been threatened with death or having their offices blown up by distraught workers facing layoff. Some laid off workers have resorted to less violent means, harassing managers by following them wherever they went, to meetings, homes, even bathrooms (China Daily 20 June 1989:3, cited in Jackson (1992: 156)).

In today's China, layoff is now referred to as workforce reduction on a collective base in state firms in the face of harsh economic conditions. This can be illustrated by the two special case studies revealed in chapter 7.

Among the six pharmaceutical firms studied, the three old state firms (see Table 5.2) adopted the layoff policy as a means of labour adjustment. The other two private pharmaceutical firms studied, and one newly established SOE (i.e. PhS-5) located in Shenzhen shun the layoff policy. At first sight, it seems contradictory to common sense that SOEs should not adopt such a radical capitalist approach to workforce adjustment. Behind the layoff policy is the government backup (as will be shown in chapter 7). In other words, without the government support, such a radical approach to numerical flexibility could be successfully implemented in SOEs.

Another significant characteristic associated with laying off is that laid off workers are not released to labour markets, instead, they are all kept inside and dependent on the company's payment for their basic living expenses in absence of social security.

> **Case study PhW-1: 'We need reduce redundant workers on a large scale'**
> According to the general manager, there are 10 to 15 percent of redundant employees in the company (i.e. 400 employees on the payroll). These redundant workers, if laid off, will not have any adverse effect on production while saving on a lot of overhead costs. The majority of the perceived redundant employees are mainly staffed on the second line, namely administrative staff, middle managers, and maintenance employees in administration office (the so-called first line is tight, while the second line is loose, and the third line is redundant). Top management plans to streamline the second line personnel by 30 per cent in two years. Those laid off staff will be internally reallocated

> to the first line of production in plants. If they are unwilling to accept a production job, they will be forced to choose leave.
> In the past two years, a limited progress was achieved in streamlining second line staff members. Although implementation of labour contracts has broken up the demarcation line between production workers *(gongren*) and managerial cadres (*ganpu*), the majority staff is reluctant to accept a new assignment in production plants. They considered of being workers as degraded and lost face, even though they are technical capable. Most of them chose to leave or took a job outside the company.

Here, layoffs can be seen as forced leave on a collective scale, and could be wielded by managers in SOEs to adjust labour to offset adverse effects of market fluctuations. In practice, it evolves as a means of getting the weakest workers out of the state-owned company. The elderly and low skilled workers are most likely to be targets of layoff, as will be shown in chapter 7. There is some exception, for instance, in the PhW-2.

> **Case study PhW-2: Internal assignment of layoffs**
> In the company, ten employees were laid off once-and-for-all in 1997. Most of the layoffs occurred among managerial and administrative staff. The minority of layoffs was production workers. For the laid off staff, some of them were internally employed elsewhere such as in the company's subsidiaries, or newly created affiliated secondary corporations. The remaining laid off employees (including laid off production workers) became vacancy waiters administered in the company. The company strongly encourages vacancy waiters to find a job elsewhere so as to suspend the payment of basic living expenses to them.

However, the prevailing practice of laying off itself in old state firms shows a limited contribution to numerical flexibility, as the majority of the laid off workers are still required to keep inside the company as an internal labour market pool. Hence, managers of these state firms are very sceptical of the effectiveness of this policy (see the case study PhW-3 below).

> **Case study PhW-3: No longer resort to layoff**
> As compared to other counterparts, the company has not left redundant employees after 40 employees were laid off in 1996-97. The top management will not resort to the downsizing policy any more. According to the general manager interviewed, the move to massive layoffs is not always very helpful to the company's competitiveness. First, the recourse to layoff can easily give rise to '*adverse selection'* effects, i.e. losses of key expertise, as well as the break-up of the organizational memory associated with the leave of best personnel. Second, layoffs also exert negative impacts on the overall employee morals. Third and, most significantly, layoffs obviously run counter to the development trajectory of the company

> that has been relying upon on the idiosyncratic knowledge accumulated by the incumbent employees after the descendants of the founder four centuries ago. In effect, there is no pressing need for downsizing in sight since the company's business is growing quite well in terms of sales turnover on markets.

In contrast, the private firms studied, due to their weak legitimacy in society, usually avoid using the lay off policy toward their employees on a collective base, as is the case in state firms. This is especially true in the two telecoms firms (TeleW-1, and TeleS-2), where rapid growth of business, coupled with cautious recruitment and selection (as will be shown in the following Chapter), keep out room for redundant workers.

> **Case study TeleW-1: No room for redundant workers in the company**
> The company does not have redundant workers given the continuous growth of business in recent years. For instance, the company has five times expanded its production capacity since 1992, thereby generates demands for new personnel each year. Despite this, new recruitment activities are under a strict reviewing and monitoring even though there is a shortage of manpower in the company. In most cases, an internal manpower shift and adjustment is first sought before an external recruitment is launched. Such conservative (or cautious) personnel recruitment stems from the consideration that the company does not want to stain its image of the proclaimed no layoff policy. In essence, the company does not have needs for layoff or downsizing.

To conclude, layoffs mean head cut and cost saving. The presence of layoffs in China's SOEs can be attributed to intensified competition, escalating costs associated with employees, and increased pressure from the government. Although most Chinese managers, as indicated above, hold a negative image of the layoff policy, layoffs take place most likely in the studied old SOEs with redundant workers that are absent in non-state firms investigated.

There are two reasons for the absence of layoff policy among the studied non-state firms. First, layoff often represents a failure of management to contain costs; second, the recourse to layoff signals a bleak prospect of the company. Therefore, while all the private firms studied try to avoid using layoff as a means of adjusting the size of the workforce in their organisations, state firms have to resort to mass layoffs to cut down redundant workers, with the support of the government. In this sense, non-state firms, in lacking government support, are more concerned than SOEs with potential adverse effects of layoffs on employees' bottom line performance.

5.2.3 Job quitting

Job quitting is indicative of labour turnover that implies a halt to labour relations. Labour turnover, when seen from the personnel management, should come under the control of personnel specialists if the organization is to maintain its continuous operations. However,

frequent personnel quitting among the employees can incur high costs to the company in terms of losses of firm-specific skills and expertise, as well as of investment sunk in training (Williamson, 1975).

Often, job quitting is seemingly a voluntary leave at an individual's own will. However, management can manipulate or “initiate” individuals’ job quitting to force targets to leave without incurring obligations. And a certain level of labour turnover in the form of quitting can increase numerical flexibility of labour in organizations from the personnel flow perspective. Hence, quitting is not always a liability of the company. It is particularly desirable when quitting gives room to bring in more qualified and skilled personnel without damages to the organization’s competence base and skill configuration (Flood et al 1995; Paauwe 1997).

In China, the incidences of job quitting rose as labour reforms abolished the lifetime employment system in the state sector in the 1990s. The recent round of reforms on enterprise-based housing provision, free medical-care, and other welfare services further has accelerated job mobility through quitting (see chapter 2). It is assumed that these reforms can give rise to "constructive labour turnover" (in Paauwe’s word, 1997) in state firms where the cemented employment relations will be dissolved.

Empirical findings from this research reveal that individual-based job quitting is on the rise in all eight firms studied. Although it is hard to distinguish between job quitting is out of individuals’ will and that initiated by management on purpose, management can influence incidences of job quitting as a means of labour adjustment, wittingly or unwittingly.

A difference in job quitting incidences is observed between old state firms and newly created firms (state and non-state-owned). While a very low rate of quitting remains in three old state-owned pharmaceutical firms (i.e. PhW-1, PhW-2, and PhW-3), two newly established private firms (i.e. PhW-4, and PhS-6) and one young state-owned firm (PhS-5) report a relatively high rate of quit that ranges from 10 to 20 per cent. The low rate of quitting incidences in SOEs points to immobility of employment still cemented by company-based housing and welfare systems (Wang and Murie, 1996). It also reflects a dilemma of adverse selection effects facing both employees and management under the recent labour reforms towards flexibility (see the case study PhW-2).

Case study PhW-2: Quitting and adverse selection

In the company, quitting occurs most likely during downsizing touched off by layoffs. In effect, not all the redundant workers were laid off as forced leaves. Some of them were actually voluntary leaves before the layoff policy was imposed. For instance, elderly workers who had physical diseases are willing to become early retired. Joining voluntary leaves are most likely those young employees or technicians possessing specific expertise with employment opportunities elsewhere. In recent years, these unwanted leaves are on the increase but under a controllable level, because the company adopts a biased housing provision policy in favour of excellent employees. If the skilled employee insists on leaving, the company will give way to him and takes back his housing. Moreover,

the company will terminate his employment position and no longer maintains his post as it did years ago.

The two private pharmaceutical firms studied (PhW-4, and PhS-6), on the other hand, show higher rates of job quitting, due to no liabilities of the housing provision, as was the case in SOEs. In order to control adverse selection associated with excessive job quitting, management of private firms has to seek other means to retain most valuable employees either through higher pay rates or bonuses. It is also reported that in the private firms, management sometimes promotes job quitting as a mechanism of getting rid of unwanted personnel for leaving. This can explain why private firms tend to use quitting, instead of laying off, to encourage leaving, or to force unneeded personnel to timely quit (see the case study PhW-4).

Case study PhW-4: Encouraged leave, or forced leave, or both
In this private company, exit of unwanted personnel is conducted mainly through voluntary leaves induced by work pressure rather than forced leaves. In other words, redundant workers are got rid of the company mainly through work group's internal pressure, or via performance-related payments. Usually, redundant workers quit jobs voluntarily since they could not earn as much as others under a piece rate. Management intentionally does not assign sufficient work to outgoing workers. Strict working rules act as automatically streamlining mechanisms through which under-performing and disobeying employees will be got rid of the company immediately. For instance, salesmen hired on temporary contracts turn on high mobility and turnover. Their quitting is largely ascribed to their failure to fulfill their contracted sales volume. In principle, the company adopts no layoff policy towards any employee. Despite this, labour quitting is as high as 20 per cent of the total employees. Over the past three years, new entry and exit maintain at a ratio of 2 to 1. The number of new entrants was as high as 200 in 1997, while 100 quitted their jobs in the same year.

There are at least two advantages to management of job quitting over laying off. One advantage of managerially inducing job quitting over laying off is that shocks of personnel reductions caused by laying off can be buffered without incurring damages to management's reputation.

Case study PhS-6: Voluntary leaves confined to production workers
There are more incidents of voluntary quitting than dismissed employees in the company. Most of the voluntary leaves come from production workers. In 1997, there were 44 workers left the company, of which only 17 were dismissed due to their violation of labour disciplines. Voluntary leaves thus push an annual labour turnover as high as 10 per cent of the total employees. The HR manager does not consider 10 per cent of turnover as a serious problem for the company as far as the turnover is confined to production workers.

Second, job quitting can save compensation costs that might otherwise have to be paid out in the case of layoffs in forced leave. This is so because via voluntary leave workers will lose their rights to claim extra compensation for leaving from the company, although it is *de facto* forced leave. In this respect, top management of the newly established state firm PhS-5 located in the SSEZ takes actions identical to a private firm in dealing with redundant personnel. Here, management can deliberately manipulate voluntary leave by either overloading the employees with unaffordable work or reducing their wage payments through insufficient work assignment.

> **Case study PhS-5**: **Encourage leaves through reducing payments**
> Frequently, as slump in product market demands implies the reduction of manpower, less working time is applied. Accordingly, reduced wage payments are made to regular workers. Under such circumstances, workers tend to leave voluntarily if wages fall lower that the local average. Hence, less working hours, coupled with abated payments under the piece rate, force workers to choose leave rather than stay. This is no need to layoff. Some labour turnover is, however, *de facto* forced leave especially when employees are at bay but to leave, for instance, due to the high fines linked with the failure to finish contracted tasks that imply little income or no income ensues.

Similar to the private pharmaceutical firms studied, job quitting in the two telecom firms studied serves as a means of labour adjustment in organizations. What differentiates the studied two telecom firms from private pharmaceutical firms when resorting to quitting is that management intentionally maintains a certain level of quitting rates to get unqualified employees out of the organization (see the case studies TeleW-1, and TeleS-1).

> **Case study TeleW-1: Maintaining 4 per cent exit rate through strict performance appraisal**
> The company has a mechanism of personnel exit through which unqualified employees can be timely removed from the company. This is carried out through the performance appraisal system that comprises *task achievement, work attitude, and individual ability*. Dissatisfied employees who fail to pass the performance appraisal will be sunk into an internal labour market administered by the HRM department. A short-term training program is offered to them acquiring additional skills before a new assignment is given. If they still display poor performance, they then will face an encouraged departure. In this way, the company puts persistent performance pressures on employees for commitment, whereby the company maintains the average annual exit rate at 4 per cent.
> Despite this, labour turnover in the company remains low, around 4 per cent of total employees on the payroll each year, as compared to 10 per cent in other firms in Shenzhen. The low level of labour turnover can be ascribed to the prominence of its unique corporate culture that emphasizes on *entrepreneurship, initiative, commitment, and cooperation*. This is accompanied with collective compensation, coupled

with individual compensation, in the forms of both cash (i.e. wages) and stock options. As a result, all the employees have a strong sense of corporate identity, and the sense of common interest community.

Case study TeleW-1: Strict performance appraisal push poor performers at bay but to leave

Individual performance appraisal is carried out once a year in the company. The functional department manager, or supervisor, conducts the performance appraisal, using a structured evaluation that is designed for this purpose. The HRM department collects the results of appraisal that will be recorded on employees' personal file as a proof for internal promotion and wage raise. Persistent poor performance records will result in termination of labour contract or a dismissal. Every year there are about ten employees leaving the company due to their failure to pass the performance appraisal.

In summary, job quitting, at first sight, is the termination of employment from individuals' will. It is seemingly unlike collective-based layoffs as encountered in the event of downsizing. Moreover, quitting most likely takes the form of voluntary leaves as compared to forced leaves in the case of layoffs. However, empirical evidence from this research suggests other facets of job quitting beyond individuals' options. In particular, management can initiate job quitting intentionally, with the purpose of streamlining the workforce. And such manipulated job quitting occurs more often in private firms than in state firms included in the study.

Management-initiated job quitting can obviously bring several advantages to the firm over forced layoffs. This is so because quitting is subject to substantial managerial arbitration and manipulations. Often, involuntary leaves under the guise of voluntary quitting are *de facto* forced-leaves deliberately manipulated by management to get rid of unwanted personnel. There are various tactics/strategies that management can use to promote employees to quit their jobs. Some are more obtrusive (e.g. strict performance appraisal), while other more unobtrusive (e.g. discriminated task assignment, and biased bonus payments). Hence, it is hard to distinguish voluntary quitting from involuntary leaves.

However, management by deliberately encouraging job quitting often confronts a dilemma of *adverse selection*: i.e. skilled employees whose employability is elsewhere higher, are most likely to quit their jobs in the declining firm and take a high paid job in the growing sector. In order to cope with adverse selections arising from quitting, state firms tend to moderate unwanted quits by using all the available means (such as housing) to retain the most mobile employees with special expertise, whereas private firms tend to offer attractive salaries or bonuses to keep skilled employees from quitting. Quitting, as is observed, is increasing in private firms, but remains relatively low in size in the state sector.

5.2.4 Dismissing and firing

Dismissing and/or *firing* is another form of radical labour adjustment that management deploys to push employees at the bay but to leave. The outright managerial objective associated with dismissing and firing is often aimed at removing the '*black sheep'* from the organization. The end result of dismissing and firing is the increased labour flexibility in the sense that management adjusts labour components in numerical terms. Seen from this logic, the imposition of dismissing and firing on target employees is not so much different from the resort to the layoff policy. However, management's resort to dismissing and/or firing is subject to legal regulations and industrial relations constraints, which differ from country to country (Kerr and Staudohar, 1994; Dunlop, 1994; Osterman, 1989; OECD, 1999).

In pre-reform China, dismissing and firing were not allowed politically and economically simply because workers were regarded as the master of house in socialist society. The use of dismissing and firing was considerably restricted and applied only to employees whose breach of stipulated labour discipline or operational procedures that incurred a huge loss to the state firm (Walder, 1986; Warner, 1991). The rights to dismissing and firing were formally granted to management in foreigner-invested joint venture in the early 1980 as part of the preferential policy attracting foreign investment (Howell, 1993; Korzec, 1992). The 1994 Labour Law set up detailed procedures and legal regulations governing dismissing and firing in all kinds of firms.

Empirical evidences from this study show growing but still limited incidences of dismissing and firing in most firms studied. In all the six pharmaceutical companies investigated, dismissing and firing is only sought by management as a last resort (see the case study PhW-3). This means that such practice is limited in application at the workplace. Indeed, limited incidences of dismissing & firing incurred in most firms studied due to employees' behavioural disobedience (see the case study PhW-4).

> **Case study PhW-3: Firing as a last resort**
> According to Labour Law, dismissing and firing can apply to those workers who have violated labour disciplines or incurred heavy losses to the company due to their misconduct or negligence on duty. In 1997, only three such employees were dismissed in the company because of their violation of labour disciplines. Management is reluctant to resort and/or not accustomed to a radical dismissal policy. They perceive such a policy running counter to their personal affections. One manager said he used to hear the incidence of dismissals in a capitalist society. "We tend to use a rhetoric term 'layoff' instead." The outcome of review must be reported to the personnel department for a record.

> **Case study PhW-4: Using firing to correct misconduct**
> Apart from the Labour Law, the company relies on a set of comprehensive work rules to govern entry, staffing, and exit in the company. Top management claims that *promotion depends on one's performance; stay and dismissal rest on self-management according to rules.* In principle, the

company promises no layoff policy toward any self-disciplined employee. However, firing is mainly used to correct misconduct of the employees.

In the two telecom firms studied, the incidence of dismissing and firing is particularly low (e.g. TeleW-1), or absent (e.g. TeleS-2). In TeleW-1, for example, the reported two incidences of firing occurred in 1997 were related to either failure to perform assigned job tasks, or violation of labour discipline.

Like the radical laying off practice, dismissing and firing enable management to adjust the components of the workforce, thereby eventually increasing labour flexibility. But such adjustment is very limited, as shown in this study. On other hand, dismissing and firing should be distinguished from laying off in today's China. First, dismissing and firing is straightforward a forced leave that occurs usually on an individual's base due to the violation of labour disciplines. The justification of the use of dismissing and firing is placed on one's disciplinary behaviour as much as, if not more, on his work-related performance. Second, when management resorts to dismissing or firing, the sacked persons have to leave their working company without any claim on compensation as in the case of being laid off. To some extent, dismissing and firing serve as a penalty against disobedience to management in order to tighten labour discipline in the workplace.

In short, the empirical findings from this research echoes the result of other researches on China's human resource management in that firing and dismissing occur extremely rare as a management tool in both state-owned and non-state firms (e.g. Warner 1995; 1997; Child, 1994). However, some strides in legislation are made as dismissing and firing is allowed, and can be used as a managerial stick to kick out undesirable personnel from organizations. In recourse to firing as a means of exploring a new frontier of flexibility, the two private firms studied seemingly move more aggressively than their counterparts in the pharmaceutical sector.

5.2.5 The use of temporary workers

The most flexible component of the workforces is *temporary workers* (*temps*) who can be used to meet irregular demands for personnel in the organization. In the West, temps are increasingly used to buffer effects of adverse market shocks on the firm, and to increase the organization's responsiveness to product market changes (Osterman, 1994a). Temps are, however, employed mainly as the periphery of the workforce with variable short contracts vis-a-vis a diminishing proportion of the core workers with long-term contracts (Atkinson, 1984).

The empirical findings from this research reveal that 'temps' are increasingly employed and utilized by the investigated firms. Yet, the way that temps are hired and compensated differs among the six pharmaceutical firms studied. First, some firms hire temporary workers directly from local labour markets (such as PhW-1, PhW-4, PhS-5, and PhS-6), while others resort to intermediary temporary help agencies (i.e. the local street community committee) for services on contract (in the case of PhW-2, and PhW-3). Second, and related to the first, methods of payments for temporary workers vary from case to case.

Some firms pay temporary workers directly on piece rate or tasks (in the cases of PhW-1, PhW-4, PhS-5, and PhS-6), while others compensate temp through agencies (PhW-2, and PhW-3).

> **Case study PhW-2: Relying on the external agency for temps**
> The need for temporary workers in the company is mainly met through a local street community committee where a temporary pool (made up of local unemployed youths and layoffs) is reserved for all near-by located companies. The company has an agreement with the local street community for the provision of temp services. The company does not need to compensate temporaries directly but pays to the street community by hours or days of services that temps have made. In this way, transaction costs of hiring temp are minimised, and the workload reduced. Temporaries come on call to take unexpected tasks such as unloading, packaging, and etc. Sometimes, these tasks are performed by the company's layoffs.

Thirdly, some companies rely on hiring a large number of temporary workers to undertake specific tasks on a season base (e.g. PhW-4 hire 15,000 temps for sales promotion each year), while others hire temp on a regular base (such as for gate-keeping in PhW-1, and PhS-5).

> **Case study PhW-4: Large scale hiring of temps for sales promotion**
> Each year during spring and summer seasons, around 15,000 temporary workers were locally recruited and employed on a contract of less than three months for market sales promotion. For instance, temporary workers are hired to deliver newspapers to households, and their payments depend on the number of papers delivered. In spring and summer seasons, a large number of temporary salesmen are hired to promote sales in local market segments. In addition, temporary workers are occasionally hired to undertake loading and unloading tasks during production peaks and sales seasons. Gate- keepers are temporary workers hired on an annually base.

Fourthly, a firm's location makes a difference to management in hiring and firing temporary workers. The two firms (i.e. PhS-5, and PhS-6) located in the SSEZ are subject to more strict regulations than other firms located in Wuhan in terms of hiring and compensation. In the SSEZ, for example, the number of newly hired migrant workers must be reported to the local Labour Bureau for registration and approval. And it is also a requirement that migrant workers be covered by a labour contract. The difference stems mainly from government labour market policies regulating the hiring of temporary workers that differ from one labour market to another. Therefore, firms located in the SSEZ have to restrain their freedom in the use of temps at will.

Case study PhS-5: Regulated temporary labour markets set a constraint

The company hires a few temporary workers to take temporary tasks such as loading or unloading, cleaning, washing, and etc. The company cannot hire more non-local temporary workers (i.e. migrants) than it would like to have. This is so because the use of migrant workers is strictly regulated by the local government labour policies. That is: the company has to report the number of employed migrant workers to the local Labour Bureau for approval; and any migrant workers employed in the company must be covered by a labour contract. As a state firm, the company is subjected to regular inspection in the use of labour.

Case study PhS-6: Contracting-out temporary tasks

The company only hires very few temporaries all the year round to take auxiliary jobs such as cleaning, guarding, loading, and etc. Most temporary workload is contracted out to other specialized firms instead. In fact, there is not a distinctive divide between temporary workers and the formal employees in the company. What really makes a difference in employment is between locals and non-locals working in the company with the same duration of labour contract.

In the two telecom firms investigated, the rationale for the use of temps is similar but the treatment of temps is quite different. Whereas TeleW-1 resembles state firms in most respects to temps, TeleS-2 takes a distinct (i.e. human) approach to temps that prove effective in eliciting efforts and commitment from temps.

Case study TeleS-2: Equal treatment of temps for high work efforts

The company employed 200 temporary workers in 1997 undertaking cleaning, gate-guards, and loading or unloading. Temporary workers are mainly recruited from migrant workers on local markets. Some of the temporaries have a contract of six months, while others are hired without contracts but under the time rate. That means that temporaries are rewarded according to the working hours that they work for the company on specific tasks. Unlike other companies in SSEZ, temporary workers are perceived as part of the employees in the company, although they cannot enjoy the same wage rates of the regular employees. The top management claims that every one working in the company has equal dignity and privilege. The result is high commitment of temps with a low rate of turnover.

In short, there is a trend of the growing use of temporary workers to undertake precarious simple tasks observed in all the investigated firms. The temps' work tasks are characterized as unpredictable, unstable, and precarious in nature. The skill requirements for such tasks are very low and non-firm-specific. Like a '*spot market*' postulated by Williamson (1981), temps are hired and paid on contracted work tasks without guaranteed fixed working hours per week. There is a high substitutability of temps in China due to the unlimited supply of unskilled labour pools in the near future. Once the contracted

workload is finished, the temporary employment relations terminate automatically. Except for the pre-determined payments for contracted tasks, temporary workers will not receive any other compensation such as health insurance, pensions, and fringe benefits as enjoyed by regular employees. Moreover, temporary workers are exclusively not countered as regular employees reflected on the company payroll in all the firms studied.

5.2.6 Summary

The foregoing empirical analysis highlighted five forms of numerical flexibility under practice among the eight studied manufacturing firms from the pharmaceutical and telecom sectors. It was found that each form of flexibility is utilized unevenly both within and among the investigated firms. *Flexible working time arrangements* (i.e. work shift, overtime, and part time working) are widely deployed by management to organize work of regular employees on the ground of cost-cutting consideration. The frequency of flexible working arrangements applied is linked to the need of production for extra personnel demands, which is ultimately determined by the firm's product market. *Laying off*, *quitting*, and *dismissing and firing*, which were not allowed in pre-reform China for various political reasons and as indicative of labour turnover in the West, are selectively used by Chinese managers as a managerial tool for labour adjustment under the changing business environment. A large scale laying off of redundant workers are mainly attempted in old state firms, with the political support of the state government, whereas individual-based quitting and dismissing and firing are managerially used most likely in private firms to kick off undesired employees (i.e. 'black horses'). *The use of temporary workers* is increasingly present in all the firms studied. However, job contents of the temps are confined mainly to precarious manual tasks that are usually unwilling undertaken by regular workers. Temps are increasingly employed, especially in the private firms studied. But temps are the *de facto* periphery of the firm's workforce, whose pay and employment is not secured. Like the West, temps in China's firms serve as buttresses against the adverse effects of internal labour market changes.

Clearly, numerical flexibility is mainly sought from production workers, and to a less extent, from external temporary workers. Both are in excess supply in China, and perceived by management as the peripheral workers in the firm. Numerical flexibility is largely internally achieved on segmentation of workers on the basis of occupations in the firm. This is so because the majority of production workers can easily be hired and fired on spot markets. And even if they are employed on a regular base, management tends to maintain primitive team employment relationship with this sort of employees. The governance of employment relationships of this type is rooted in labour market segmentation, on which both employees' human capital and employment status come into play.

Apparently, management's cost-cut considerations dictate an internal logic of the five forms of numerical flexibility practices as observed in the firms studied. Except for technological reasons, the firm with no work shift tends to choose part-time working arrangements to adjust labour volume to markets, whereas firms with work shift usually adopt overtime work arrangements for higher flexibility. Subsequently, flexible working

time arrangements can go well with managerially manipulated labour component adjustment through laying off, quitting, and dismissing and firing (indicative of labour turnover in the Western sense). Eventually, the workforce is increasingly used flexibly and linked to management's efforts to efficiently organize work on the cost-effective base.

Some differences are evident in the use of the five flexible working practices between state and non-state firms, between old and newly established firms. Radical labour adjustment practices (i.e. laying off, and dismissing and firing) are carried out mainly in studied old state firms, due to management's accessibility to government support, and limited legitimacy rooted in state ownership. This is in sharp contrast to the newly created firms included in this study that tend to initiate job quitting, instead of laying off, or dismissing, to wipe out unwanted 'black horses' from organizations. By so doing in newly created firms, management has to cope with adverse selection associated with job quitting. Another difference as related to labour market conditions is found between firms studied selected from Shenzhen and Wuhan. Firms situated in Shenzhen are subject to stricter labour market conditions on the firm's decision to employ temporary workers in terms of contracting, equal labour conditions, and treatments. A cross industrial comparison shows a slight difference in the extent to which five forms of numerical flexibility are used and the way that each form of flexibility is employed in the firms studied from the two different industrial sectors.

In the next section, the focus of analysis will be shifted to the forms of functional flexibility practices adopted in these firms. The purpose is to find out to what extent different forms of functional flexibility practices have developed and penetrated at the workplace in the firms studied.

5.3 Functional flexibility: value-added work practices

As defined in chapter 3, functional flexibility concerns the value-added aspect of the workforce by varying the content of work. It means that work can be organized in such a way that the workforce is able to carry out a wide range of tasks. This can be achieved through teamwork since "firms exist in large part because working together is more productive than working as individuals" (Lazear, 1998: 303). Moreover, managers need to rotate individual employees periodically across teams or functional departments in the light of their idiosyncratic competence, or avoid forming overly "strong bonds among groups of co-workers" (Baron and Kreps, 1999: 319). In addition, work can be organized through vertical integration of job tasks (i.e. job enrichment), or horizontal integration (i.e. job enlargement) since "job enlargement and enrichment can potentially increase organizational flexibility, both in the short-term and the longer term" (Baron and Kreps, 1999: 317). Occasionally, outsourcing is sought in order to increase functional flexibility, not merely out of pure cost effective consideration. However, the potential of flexible work organization cannot be realized without fundamental changes in the management style toward empowerment and decentralization. Likewise, employees should be given more opportunities for training so as they can take up multi-task jobs as required (Pfeffer, 1994; Osterman, 1994b).

Table 5.3. Summary: Profile of functional flexibility practices in the eight firms studied, in 1997

Forms of functional flexibility practices	PhW-1 (SOE)	PhW-2 (SOE)	PhW-3 (SOE)	PhW-4 (Priv*.)	PhS-5 (SOE*)	PhS-6 (Priv*)	TelW1 (Jovt*)	TeleS2 (Priv.)
1. Teamwork	-	-	-	+	-	+	+	+
2. Job rotation	+	+	+	+	+	+	+	+
3. Job enlargement	-	+	-	+	+	+	+	+
4. Job enrichment	-	-	-	+	-	-	-	+
5. Outsourcing or contracting out	+	+	+	+	+	+	+	+

Note: "+" = present " – " = absent. Figures in the cells indicate the relevant number of incidences occurred in 1997. "*" denotes the presence of foreign investors.

Like numerical flexibility examined in the preceding section, five forms of functional flexibility practices are attempted at the core workforce (i.e. skilled workers) as observed from the eight investigated firms selected from the pharmaceutical and telecom industrial sectors. Table 5.3 summarizes empirical findings on teamwork, job rotation, job enlargement, job enrichment, and functionally contracting out in each studied firm. These practices concern how work is organized, how employees are relocated, how jobs are defined (widely or narrowly), whether there is empowerment, and to what extent functionally contracting out occurs.

The following analysis will look in details at how and to what extent the five identified forms of functional flexibility are pursued and achieved in the firms studied.

5.3.1 Teamwork

As indicated above, teamwork is frequently used to organize work in a small group with autonomy, from which functional flexibility is expected. The way in which teams can be granted autonomy depends on specific tasks undertaken in a group. In order for individuals to work together productively, management must know how to set up teams and motivate team members. Two fundamental questions are concerned in teamwork: how to set up teams, and how to motivate the team members. In principle, a team must be built up on skill complementarities of the team member employees that can bring higher performance to the firm than individuals do alone. Moreover, team-based reward systems need to be designed from which the ensuing free-rider problem can be effectively avoided (Lazear, 1998).

Teamwork has advantages over other forms of work organization. First, teamwork is able to transfer knowledge among team members as each member specializes in one specific task. Second, the team has a role of self-governing in the sense that it determines internally how the tasks should be accomplished (Baron and Kreps, 1999: 323). Because the team constantly pressures its members to work continuously (i.e. maintaining function), innovate and improve the process (learning function) (Buitendam, 2001: 146-158). Hence, routine discipline on tardiness and absenteeism can be enforced without the overt role of

management (Kenny and Curry 1996: 38). In short, virtues of the teamwork lie in that it allows many flexible staffing patterns such as switching self-managing team members from job to job.

This empirical study shows that self-management teamwork is present in private firms while absent in state firms included in the investigation. In the pharmaceutical sector, hierarchical work organization prevails in the studied six pharmaceutical state firms, without empowered team in functioning. Even in the studied two private firms (i.e. PhW-4 and PhS-6) where a team is reported, teamwork is primitive in the sense that teamwork applies where technical settings are suited. In addition, the presence of teamwork in the two private firms is mainly restricted to some functional areas of operations, such as sales promotion in remote market segments (in the case of PhW-4), or quality control activities that are incorporated into production processes at the plants (in the case of PhS-6).

> **Case study PhW-4: Work teams for sales promotion**
> During the sales promotion period, a self-management work team is made up of a staff member dispatched down from the center and a number of locally recruited salesmen for a market penetration and development. Their wage payments are linked to sales volume achieved during that period of time, and that sales volume is recorded as a criterion for promotion. This is so because the sales of medical products produced by the company are mainly concentrated in spring and summer seasons (so-called golden seasons).

In the telecom sector, teamwork is widely used in the organization of work. Teamwork applies not only to production plants; it also extends to other functional areas such as R & D (see the case study TeleS-2). The application of teamwork in production plants has much to do with technologies used in the telecom-manufacturing firms (see the case study TeleW-1).

> **Case study TeleS-2: Quality circle along with teamwork**
> In the company, various work teams are set up on the project base in the R & D department, the largest functional department in the company. The project manager is responsible to select participants onto a team, and summons team members for technical breakthroughs. On the team, each member is committed to the project by bringing in his initiatives. There are not so many employment status differentials among them. Compensation is tied to the success of the project.
> In production plants, workers are required to understand the design of each part in the processing process, and to adjust the parameters when a derivative emerges from the design. Quality circles form in the plants accordingly. The function of quality circles is to solve technical problems arising from the production and to guarantee no defect products off the line. Production workers are working in teams with PC-aided manufacturing station. Each must learn technical skills of others in the case of emergency, or absence. Each team member is willing to, and has to learn to be cooperative with others on the work team. Although there

is labour division among the team members, job descriptions are generally wide, and task sharing expected.

Case study TeleW-1: Teamwork for getting work done cooperatively
Teamwork is promoted from the top management team down to production workers in plants. In the Sales Dept and After-Sales Services Dept where multi-skills of marketing and technical skills are specially required, teamwork forms as one of the best way to get tasks done. In production plants characterized by advanced automation and technological complexity, a team of two workers runs the entire production line. Each member must be working in cooperation and sharing tasks and responsibility. There is not distinctive divide between tasks of each employee. Quality cycle activities are incorporated into the teamwork. In addition, good suggestions are encouraged of each team member regarding the likelihood of improvements in the company from his viewpoint. HRM department is responsible for handling employees' suggestions.

However, teamwork in the private firms studied does not always come with the delegation of management authority. More often, teamwork leads to intensified work, peer pressure, self-disciplining, and quality control. As a result, employees are not always happy with teamwork that implies more responsibilities, eventually higher work stress (see the case study PhS-6).

Case study PhS-6: Work teams and incorporated quality inspection
In the company, job descriptions are relatively wide and vague in certain function departments, such as in marketing, engineering, and production planning where work teams usually form to get work done. Even in production plants, mutual communication and assistance are expected of each employee especially during his colleagues' absence or in the case of emergence along the line. Quality inspection is incorporated in the production process, which requires self-directed work teams for constant quality control. Failure to meet the stipulated quality level will be subject to losses in bonus payments to team members, even basic wages. This is done by further inspection of the quality center on a random base.

To sum up, self-management team is present in the private firms studied while basically absent in the state firms studied. Even in private firms where teamwork appears at production plants, there is no the delegation of managerial authority along with the team. Strict control over work is still firmly held by foremen or supervisors. Teamwork with limited managerial empowerment is most likely to be among staff members performing managerial or technical work. State firms seem to lag far behind private firms in developing teamwork at the workplace where hierarchical control still prevails. As a result, expected labour flexibility derived from teamwork is substantially circumscribed in state firms.

5.3.2 Job rotation

Job rotation refers to lateral transfers of employees "across tasks, sub-units, or locales that differ in their appeal to ensure some equity in job assignment, or it may use frequent transfers to ensure that overly strong bonds do not develop among groups of co-workers" (Baron and Kreps, 1999: 319). Often, when job rotations occur among different lateral functional departments it is hoped that employees will spread the most onerous jobs and learn from cross-training workers. However, job designs that entail a lot of lateral transferring and cross training can be prohibitively expensive in organizations due to a lot of labour mobility. Moreover, frequent job rotations are not to everyone's taste, just like teamwork.

In this empirical study, job rotations are reported in all the firms investigated and involve lateral transfers of employees across different functional departments. Occasionally, top management intentionally uses job rotations to promote the internal job mobility upwards and downwards along career ladders (in the cases of PhW-2 and PhW-4).

> **Case study PhW-2: Blurring job boundaries**
> Increasing job rotations are observed among managerial personnel in the company, where managerial titles are no longer fixed for anybody. Readiness for internal job mobility is assumed and opportunities for a career development opened to all employees
> Job rotations are also promoted among administrative staff working in different functional departments such as accounting, financial management, marketing and sales, and securities. Management assumes that rigidity and inadaptability might arise if one stays in one department for one position over a long period of time. Job rotations can also prevent fostering the sense of job ownership and departmentalism of employees working key functional departments. The government also expresses the worry of possible occurrences of corruption in the some functional departments if one holds key position there for a too long time.
>
> **Case study PhW-4: Job rotation promoted along value added chains**
> In the company, job rotations take place in managerial undertakings across functional departments in value added chains. Usually, managerial staff is subject to a rotation, i.e. being dispatched down to local market segments for sales promotion for three months a year. Top management hopes that the outright exposition of managerial staff to marketing and sales promotion can provide practical opportunities for headquarter managerial staff to stay closely with market frontiers. Such a job rotation is filed for a career promotion.

However, job rotations as claimed in some state firms studied represent a managerial effort to reduce redundant staff members, through reallocating second line staff to production plants during downsizing (in the case of PhW-1). Here, job rotations imply a managerial difficulty of laying off redundant staff in the state sector.

Case study PhW-1: Job rotation associated with staff reductions

The company had roughly 400 redundant employees (in 1997) who were mainly staffed on the second line, namely administrative staff, middle managers, and maintenance employees in office. This is so-called '*the first line is tight, while the second line is loose, and the third line is redundant*', a typical work situation in state firms. Top management decides to streamline the second line redundant personnel by 30 per cent in two years. Those sacked staff personnel will be internally reallocated at the front line of production. If staff employees are unwilling to accept a production job, they will be faced up leaving. In general, redundant staff is reluctant to accept a new assignment of being production workers, because they perceive of being workers as degraded and face-losing, even through they are technical capable. As a result, most of the sacked staff chose leaving or taking jobs elsewhere.

In order to prevent qualified managerial employees from leaving during downsizing, top management promotes job rotations by functionally shifting their positions between their office work and production plants on an irregular base. In this way, the demarcation line between the staff and the workers are blurred through job sharing, albeit downwards in mobility. This kind of functional flexibility received unexpected outcomes: cooperation and commitment between workers and office staff increase without incurring employees' resistance. Both the workers and the staff accept flexible assignments, since their payments are linked to their performance on different sites. Another positive effect is that both workers and staff start to care about their performance, or align their work efforts to goals of the company. More significantly, job rotations enable employees to develop flexible skills that are otherwise unavailable.

Sometimes, job rotations between production workers and managerial staff involve both job promotion and demotion, as shown in the case of PhW-3.

Case study PhW-3: Promotion or demotion in the name of job rotation

In the company, job rotations often occur between and among production workers and administrative staff, especially during a production perk. By rotation, qualified production workers can be promoted to take office jobs, while poorly performing office staff be demoted to work in the production line. In particular, middle managers no longer enjoy lifetime management titles if they are unable to assume their supposed responsibilities. Consequently, every staff member is under pressure to perform tasks subject to a constant following up check. Similarly, a production worker's performance is evaluated monthly by foreman or supervisor in the first line. The result of performance appraised has direct impacts on one's pay and promotion.

In the two telecom manufacturing firms studied, job rotations are largely associated with career developments of managerial, technical, and administrative staff with a potential for promotion. In contrast, few incidences of job rotations are observed among production workers at production plants. In TeleS-2, for instance, job rotations are heralded as one of the corporate rules applicable to the certain segment of staff.

> **Case study TeleS-2: Job rotations linked to promotion**
> The Company's Corporate Basic Law clearly states that: "regular managerial job rotations apply to middle and top managers every two years." It is assumed that job rotations can broaden managers' insights into the related functional areas so that managerial skills will be enhanced. Another purpose of job rotations among middle and top managerial personnel is to maintain a dynamic mobility of key talented staff among different functional departments. Internal mobility is promoted through cross-functional job rotations.
> Frequently, job rotations go hand in hand with the principle of promotion from within. Each year, managers above the middle level are subject to a management performance appraisal, with specific indicators to measure their ability and capability. The result of performance appraisal will have direct bearings on their promotion and compensation. In principle, promotion is mainly made from within, and such opportunities are open to all qualified applicants. A life-time managerial tile is no long available in the company. Poorly performed managers will lose their titles if they cannot survive the annual performance evaluation.

To sum up, the empirical evidences clearly show that job rotations are increasingly used as a managerial control tool to reallocate staff across functional departments, tasks, and locations for functional flexibility. In most firms studied, job rotations are mainly sought among managerial, technical, and administrative staff members whose job boundaries are intentionally blurred or flexibly defined. Moreover, most observed job rotations are not always lateral transfers of jobs at the same functional level as assumed. Often, behind the job rotations is downward or upward mobility that implies either punitive or incentive purposes. In the state firms studied (e.g. PhW-1, PhW-2, and PhW-3), job rotations that are linked to the downward mobility have clearly cost containment, as well as punitive, purposes. Along with job rotations implemented at the workplace, work is usually intensified, and employees' skills are expected be fully utilized. There is not so much difference in job rotation practices between state firms and non-state firms included in this study.

5.3.3 Job enlargement

Job enlargement is referred as to a horizontal expansion of job contents on more or less the same skill level. In other words, job enlargement has much to do with job descriptions along the horizontal dimension. Typically, job enlargement can convey some explicit and extrinsic incentives to employees since, by combining multiple tasks into a single job, employees will feel confident about themselves. Moreover, workers who engaged in

enlarged jobs are likely to be more capable of and interested in acquiring new skills over time (Baron and Kreps, 1999). This means that a firm can define certain job categories widely to leave room for functional flexibility. And any job tasks that stretch beyond the proscribed job can be labeled as a job enlargement. Obviously job enlargement can considerably increase functional flexibility of the workforce.

Among the six investigated pharmaceutical firms, the two state firms (i.e. PhW-2, and PhS-5) and the two private firms (i.e. PhW-4, and PhS-6) report the existence of job enlargement in their organizations (see Table 5.3). While job enlargement is absent in other two studied old state firms (i.e. PhW-1, and PhW-3) where narrowly defined four job categories (i.e. production workers, technicians, administrative staff, and managerial staff) prevail, which echo finings of other researches (see Child 1994; Warner 1995, 1997). It seems that the ownership of the firm has no impacts on the presence of job enlargement.

Among the four firms with the reported job enlargement, job enlargement is restricted mainly to certain levels of technical, managerial, and administrative job categories, without extending to production workers. In addition, job enlargement goes in most cases with task sharing with other employees on the same job level (see case studies below).

Cast study PhW-2: Job enlargement exerts pressure on employees involved

Job enlargement is promoted among managerial and administrative staff, and sometimes between workers and technical personnel, in the company. For example, administrative staff takes managerial jobs, or share tasks with relevant functional departments. They are also sent down to production plants working there during production peak. Technical personnel are required to work at the workplace for a certain amount of hours per week, not only for solving technical problems arising there, but also for extending their technical skills to production processing and product quality management. Accompanying job enlargement is an increasing pressure on employees involved, and job insecurity in their positions.

Case study PhW-4: Job enlargement goes with task sharing

In the company, job enlargement goes hand in hand with task sharing in relevant functional departments. For instance, staff members in the raw material supply department are often called to give hands to the transportation department in the case of hand shortage. Trade unionists participate in HRM activities that do not fall in their domain. In the marketing, and administrative departments, for instance, job enlargement is applied wherever job description is not clearly defined, and job boundaries between functional departments are somewhat overlapped. Here, there is no clear job description for each staff at office. All staff members are required to work flexibly to fill in temporary job vacancies when necessary.

Case study PhS-5: Job enlargement means more responsibilities
Job enlargement and task sharing are mainly under practice among managerial and technical staff working in offices. For example, an interviewed financial department manager takes more responsibilities than the assumed. He is not only responsible for financial management of the company, but also involved in project negotiation, contract drafting, and project implementation. Job enlargement is also observed in the Administrative Department where the personnel manager performs the function of full-time trade unionists in the company. Despite this, job enlargement is not extended to other functional departments. The main concern in this regard is to maintain continuity of work and to preserve key personnel in a specialized functional area for a relatively longer period of time.

The above three case studies clearly show that job enlargement is not so pleasant for employees. Along with job enlargement arrangements are growing work pressure, and more responsibilities expected of workers involved.

The same trend is found in the two telecom firms studied. In TeleS-2, for example, job enlargement is mainly sought among managerial staff working in relatively interrelated functional departments. In addition, communication and cooperation is highly stressed in parallel with job enlargement.

Case study TeleS-2: Job enlargement with an emphasis on cooperation and communication
In the company, there are not clearly cut-off job boundaries between managerial employees above the middle level in function-related departments. In such circumstances, job description is wide in general so that each staff member at that level must have broad insights. Meanwhile, they are expected to be aware of their responsibilities for enlarged jobs. Here, mutual communication and cooperation is particularly emphasized and valued. Cooperation and communication become an essential part of performance appraisal, commensurate to employees' commitment and competence.

The above empirical evidences suggest that job enlargement be mainly pursued for increasing functional flexibility of managerial staff by putting more workload or responsibilities on them. Along with job enlargement are growing work pressure, and task responsibilities expected of workers involved. The relative emphasis on horizontal job enlargement, especially in the middle level of managerial job categories, accords with management's effort to consolidate its power vis-à-vis labour in work organizations in the name of functional flexibility. Although horizontal job enlargement sometimes involves complex tasks of coordination and quality control, it is basically restricted up to certain levels of white-collar job categories, whose enlargement will not violate but enhance the management authority in companies. In other words, top management does not want job enlargement of subordinates to impinge on their authorities, let alone undermine their job

security. No significant difference is found in job enlargement practices between state firms and non-state firms, and between the two industrial sectors, included in this study.

5.3.4 Job enrichment

In contrast to job enlargement, job enrichment concerns empowerment of managerial responsibilities (planning, quality controlling, and machine maintenance) along the dimension of vertical job integration (Buitendam, 1979; 2001).

Empirical evidences from this research show rather rare incidences of job enrichment in all the firms investigated (see Table 5.3). Except for the two private firms studied (i.e. PhW-4, and TeleS-2) that report limited job enrichment in organizations, all the other firms studied do not incorporate job enrichment into job designs. Even in the two private firms claiming job enrichment, different job enrichment practices are noted. In the private telecom firm (i.e. TeleS-2,), job enrichment is attempted at a higher level of management teams. In the private pharmaceutical firm (PhW-4), job enrichment is confined, but not limited, to some functional department managers whose positions entail prompt decision-making power in respect to marketing, post-sales services, distribution, advertising and sales promotion. It is hard to conclude that job enlargement is industrial-related, or location linked since the two firms are from the two different industrial sectors, and situated in the two different cities. Rather, it can be safely concluded that job enrichment is a reality in today's China while it is evolving from private firms (see the case study TeleS-2).

Case study TeleS-2: An emerging virtual organization

Unlike other firms included in this study, the company can be characterizes as a typical knowledge- intensive organization. In 1997, it employed 5,600 young graduates, concentrating mainly in the development and manufacturing of telecom network equipment. Of the total employees, 2,200 young professionals are working in the R & D Dept., accounting for 40 per cent of the workforce. The company has a very few of production plants (employing 13 per cent of the workforce) that only manufacture core components of telecom equipment. The remaining production tasks are contracted out or to outsourcing from markets.

In the R & D department, teamwork is an overwhelming form of work organization. Along with the team is job enlargement and job enrichment expected of the team members. The team members are working on computer-aided workstations. The work team is set up on a project base that may be part of the large research project in the company. The team leader or project manager, who won the bet in the project competition tendering, led a team group of five to 10 members. The team will be decomposed as soon as the project is finished. As a result, there is a high internal mobility within the R & D department. Within a team, job categories are widely defined, and no clear boundaries drawn between the team members. Self-management and mutual cooperation are required of each member.

> The second largest segment of the workforce is those working in the marketing and sales services (accounting for 35 per cent). In these functional areas, a group of employees working together to get telecom equipment installed, and provide with the after-sales service. Here, job descriptions are wide, and each member in the group is expected of more job tasks horizontally (job enlargement), or more responsibilities vertically (job enrichment). Mutual cooperation is particularly stressed in daily work. Nobody can independently undertake the entire installation task, or the after sales service, without other's cooperation. Sometimes, cross-region cooperation in after sales services is demanded, and employees should be ready to offer a help call from neighboring regions because of manpower shortage or knowledge shortage.
>
> Managerial and administrative staff members (accounting for 12 per cent) are in principle working in different functional departments. It is among this segment of the workforce that job enlargement and job enrichment is sought with job rotations. Job rotations with empowerment are carried out among the middle and top managers and executives every two years in order to widen their visions and sights on decision making. It is assumed that the department manager should have had work experience and managerial skills in related business domains. While job rotations with empowerment is less required from junior managerial and administrative staff in order for them to stay with jobs for a relatively long period of time for acquiring job-specific skills. The department manager, led each functional department, is responsible, as well as accountable, to an above level of management. All managerial employees are required to work with initiatives in the team.
>
> Mutual communication is stressed among managerial employees and between the manager and his subordinates. One of the prevailing forms of communication advocated by the top management is to have a meal together, with each taking a turn to pay the meal bill. The department manager, who wants to have something important discussed with his subordinates, usually makes a proposal for a lunch meal or a dinner. The theme of discussion is most likely one inappropriate or ineffective addressed during working time, but it can be very effectively solved during the meal. This is so because mutual trust can be easily established via the informal discussion during the dinner. And communication barriers can be eliminated between employees and their manager on the special occasion of dinner. As a result, good solutions are found out, and high commitment is achieved.

To a great extent, all possible functional flexibility practices are incorporated into work organization, and that helps to advance TeleS-2 into a "*virtual organization*" (Flood et al, 1995:24).

As assumed in the management literature, job enrichment is aimed at enabling workers to contribute more broadly to a final product. In so doing, workers are more apt to identify with that product and proud of its quality, thereby increasing their identification with the

entire enterprise. In addition, job enrichment has an intrinsic incentive function. It probably 'foster positive peer pressure and defuse negative peer pressure – i.e. less of an us-versus-them mentality' (Baron and Kreps 1999: 317). However, job enrichment entails fundamental changes in management behavior with respect to power delegation along the organizational hierarchy. Moreover, effective job enrichment relies on how to motivate employees, as well as how their skills will be enhanced through job enrichment.

Obviously, job enrichment as reported from the two private firms studied represents top management's intention to fully harness hearts and minds of the employees in organizations. The absence of job enrichment in the state firms studied points to the fact that state appointed top managers tend to consolidate their control over labour, rather than follow empowerment in the organization. This can partly be ascribed to so-called the "power distance" characteristic in Chinese culture (Hofstede, 1994) under which Chinese managers tend to keep distance with subordinates in daily interactions (Whitley, 1992).

5.3.5 Outsourcing or contracting out: R & D

In the Western economies, functional flexibility is increasingly sought through outsourcing some of the organizational tasks to external specialists, or forming strategic alliance (Lorange and Roos, 1992; Whittington, 1993; Roberts and Greenwood, 1997; Volberda, 1998). Here, a key criterion for outsourcing is when and how to outsource activities.

From a strategic choice perspective and a transaction cost perspective, two factors are critical for deciding which specific activity should be contracted out to individuals who carry out the task but who do not have a regular employment relationship with the enterprise. These concern *strategic importance* and *interdependence of tasks* (Baron and Kreps, 1999: 461). Usually, only tasks that are strategically unimportant and loosely connected to the other tasks of the firm are better candidates for outsourcing. For such tasks, the efficacy of an outsourcing arrangement depends primarily on the cost savings and flexibility that the client firm realizes. However, even for strategically important tasks with low interdependence on others, functional flexibility can be increased through arrangements of a separate spin-off; or forming a long-term relationship with vendor, or independent contractor (ibid: 461).

Empirical evidence from this research suggests that outsourcing is on the rise in all investigated firms. Outsourcing[20] is mainly sought in the functional area of Research and Development (R & D) that becomes a candidate for outsourcing in part or full. Particularly in two private pharmaceutical firms (i.e. PhW-4, and PhS-6), management contracts out the R & D partly or completely to external research institutions on contracts or co-operations.

Behind the outsourcing strategy lies the fact that these newly emerged private firms lack

[20] In the state firms studied, contracting out the welfare facilities (such as kindergartens, schools, hospitals, and employee canteens) is another trend of streamlining organizations (see Appendix II).

the R & D capacity at the earlier stage of growth due to liabilities of newness. In addition, contracting out part of the R & D activities can save huge amount of investments, and reduce risks, at the earlier stage of new product developments (see case studies below).

> **Case study PhW-4: Rely on consultants, contracting out R & D, and buying over**
> The company has its own R & D department led by a professor who invented a secret recipe for the key medical product produced in the company. This professor is one of the directors on the board, responsible for R & D for the sake of secrecy. Recently, the company hires a number of external experts as consultants on a contract to enhance its capacity for new product development. In order to save on costs of R & D, the company contracts out several R & D projects and buys out the results of contracted R & D activities. In an extreme case, semi-final R & D results are bought out from external research institutions at a cost that is less than the company itself makes otherwise. For instance, in 1997, the company invested RMB 100 million to buy out 20 intermediate or nearly finished R & D results from research institutes and universities in order to enhance the capacity for new product development.
>
> **Case study PhS-6: Relying on external R & D capacity**
> The company has an R & D subsidiary that employs 20 full time researchers. Their main task is to collect information on the latest developments in the pharmaceutical industry, instead of R & D activities. In order to enhance its R & D capacity as well as to avert risks in R & D, the company take a strategy of collaboration with external research institutes and universities in China and abroad, by offering them research funding, and sharing or buying out the results of R & D. In this way, the company does not have to establish its own independent R & D capacity, while possessing latest R & D achievements in demand.

Obviously, top management attempts to avoid an overall commitment to risky R & D activities although these are strategically important to firms. From the transaction cost economics perspective, buying R & D results is more cost effective than making in-house especially when the firm is at the earlier stage of the establishment.

Similarly, old state pharmaceutical firms (such as PhW-1, PhW-2, and PhW-3) also contract out some of the R & D activities that used to be done internally in the past. However, state managers in pursuit of outsourcing often encounter two constraints that their counterparts in private firms may not be confronted. First is financial constraint. Old state firms, as shown in this study, suffer acute financial difficulties as the government recently hardened budget constraints on SOEs. Second is institutional constraint. State firms have to cope with constraints of the path-dependency in launching outsourcing activities (see the following case studies).

Case study PhW-2: The R & D department is spin off for cost effectiveness
The company used to have a research institution on R & D that was split off in 1995 from the company as a financially independent research entity. The newly independent research institution specialises in R & D for new product developments, in collaboration with the external research capacities of universities. The company reserves its priority and residual rights to the use of R & D results. But internal transactions of R & D outcomes are accountable at market prices between different departments. The purpose is to guarantee continued and sufficient investment in R & D, as well as effective and efficient use of the R & D funds.

Case study PhW-3: Externalizing some of R & D activities on trust
The company has a research institute that recently externalized some of its R & D projects to university professors, who are not bound by an employment contract, but receive payments upon research results. There have been close contacts and cooperation between the research institute and outside specialists in universities based on individual trusts, not on a contract. Such contracting out must report to supervising agencies in the local government.

In contrast, a newly established state firm (i.e. PhS-5) can take advantage over its old governance structure that it inherited from the past institution environment at the inception of its establishment. This means that institutional constraints of the path-dependency sometimes turn out to be an advantage, contingent on individual managers and specific occasions (see the case study PhS-5).

Case study PhS-5: Reliance upon administrative fiats for external R & D benefits
The company has an R & D department that heavily relies upon external research institutes for new product development. The dependency takes the form of extensive R & D collaborations with outside research institutes through an administrative fiat. This is so because the company was set up through pooling investment capital of several other state firms regulated by the State Medical Bureau in Beijing. The company thus enjoys an advantage in R & D over other SOEs and non-state firms in the pharmaceutical industry. This implies more financial supports from central government agencies, and more external research capacities could be mobilized to the company.

Apart from cost saving and risk reduction, outsourcing can bring technical know-how to the firm. In the two telecom firms studied, outsourcing is increasingly sought in the area of R & D. To some extent, the development of contracting out of R & D activities in the two telecom firms represents a managerial choice for functional flexibility within constraints of technological, cost-benefit frontier, as well as institutional environments (see the case studies TeleW-1, and TeleS-2).

Case study TeleW-1: Seeking to build up own R & D capacity during outsourcing

Being a state involved joint venture in manufacturing optical fiber and cable for the global, the company completely relies on the foreign partner for R & D at the very beginning of establishment. Ten years after the establishment, the company still does not have its own R & D capacity except for some technical maintenance. Although the foreign partner promised to provide the latest optical fiber and cable technology at the contracted price for 20 years at the time of forming a joint venture in 1988, such complete reliance on the foreign partner for technological know-how will not change immediately in the near future. Because the Western world's restrictions on transferring advanced technology to China remain in the field of telecommunication.

In order to alter the long-term reliance on the foreign partner, the local government strongly encourages the firm building up its own R & D capacity. By the time of investigation, the company starts contracting out some of technical activities to local Chinese research institutes as an initial step to building up its own R & D capacity.

Case study TeleS-2: Enhancing the R & D capacity through outsourcing

The company is a leading telecom equipment supplier in China (ranked top 18th in terms of sales turnover among electronic manufacturing firms in 1997). It is aimed to become a first-class supplier of telecom equipment in the telecom world in next ten years so that it can have technical capacity to compete with huge multinationals in the world markets. The company has achieved a salient technical advantage over its multinational rivals in some key telecom equipment products. On the whole, it remains weak in the R & D investment. In order to catch up to multinationals, the company invests 10 per cent of annual sales turnover in R & D every year, with aims to make technical breakthroughs in some core telecom domains. In addition, the company established two R & D subsidiaries in Shanghai and Beijing to take an advantage of research capacity of local universities and research institutes. It also sets up cooperative research projects on GSM with multinationals such as Motorola, Nokia and Ericsson, multinational mobile telecom giants. The ultimate goal of the company is to own independent patents and intellectual rights in key telecom technologies.

Obviously, outsourcing of the R & D in the two firms studied in the telecom sector is increasingly linked to the strategy of building up technical capacity and expertise in the organization. Outsourcing has enhanced the organization's competence, and technical advance, rather than weakened its independency.

In short, all the firms investigated are actively engaged in contracting out of the R & D for cost-cut, or for bridging technical gaps. The result is the increase of functional flexibility in the organization. A salient difference is found between state firms and non-state firms

included in the study. The private firms studied are strategically pursuing outsourcing of the R & D in part or in full for enhancing the organization's internal technical competence (e.g. PhW-4, PhS-6, and TeleS-2), while the state firms studied, especially old state firms, move to outsourcing or contracting out part of R & D for cost saving.

The empirical evidences further suggest that firms in the telecom sector are more actively in outsourcing than firms in the pharmaceutical sector. However, the fundamental reason for contracting out of some of R & D activities lies in the fact that most studied pharmaceutical and telecom firms (state or non-state) lack expertise in the area of R & D, or could not afford to undertake costly R & D activities alone within organizations. Outsourcing can thus enable firms to spread risks and costs of R & D activities with contracted individuals and organizations. It also enables firms to share external expertise that is currently located in government financing universities, and research institutions. In particular, functional flexibility in the area of R & D is increased after outsourcing since it provides management with a variety of choices, technically and economically available in markets, as compared to internally one made in-house.

5.3.6 Summary

The empirical evidences on functional flexibility practices in the eight firms studied reveal a mixed result. Functional flexibility is pursued for, but not merely confined to, the value-added purpose of work organization. Sometimes, the cost containment consideration is also attempted in job rotations, teamwork, and outsourcing. Job rotations, for instance, are widely used in the most firms studied and go with punitive downward mobility. Job enlargement also implies growing work pressure on workers involved. The examined five forms of functional flexibility practices are sought mainly among the core employees consisting of managerial, and technical personnel, and to less extent, among production workers at plants.

By and large, all the eight firms studied are embarking on the initial stage of functional flexibility while facing constraints. Four constraints, as noted in the eight firms studied, are most pronounced in limiting management to pursue functional flexibility in organizations. The first constraint arises from the old management style, as observed in the old state firms studied, where management continues emphasizing hierarchical control, instead of empowerment and delegation of managerial power to subordinates. The second constraint derives from legacies of the state institutions that remain influential to the firm's survival and continued development (e.g. state research institutions, universities, and management appointment systems). The third constraint stems from financial difficulties, as revealed from the old state firms studied in approach to outsourcing, and job rotations. The fourth constraint stems from technology, as revealed in the widespread practice of outsourcing in R & D in all the eight firms studied. The last constraint can be ascribed to the organization's lack of required technical competence, which points to the need of training for skill upgrading. As these constraints play out, the state firms studied lag behind the non-state firms in a move to development of functional flexibility at the workplace.

5.4 Discussion and evaluation

This chapter has closely examined labour flexibility practices as adopted at the workplace in the eight manufacturing firms belonging to the two different industrial sectors (i.e. pharmaceutical and telecom). Empirical evidences revealed from the firms investigated have clearly shown that management are taking use of the different forms of flexibility practices to adjust labour numerically and functionally to meet fluctuations in the firm's production and product market changes.

The five forms of the numerical flexible working practices as observed in the eight firms studied are essentially cost-saving work practices, pointing to the *cost-cut* employment strategy as assumed in the literature. These practices are mainly applied to production workers, migrants, and temps (i.e. the pool of unskilled workers) in all the eight firms studied. Often, Chinese managers see production workers, migrants, and temps in the firm as a peripheral of the workforce since they are mainly made up of low skilled or unskilled workers that are in abundant supply in China (see Child, 1994; Warner, 1995). This pool of unskilled labour exhibits high substitutability. Hence, management can easily take in unskilled workers when they are needed, and get rid of them when unwanted (e.g. PhW-4, and PhS-5).

Unlike flexible practices prevailing in the Western economies, the wide practice of part-time working and overtime working in the eight firms studied is overwhelmingly applied to regular full-time workers during peak and slack production seasons, rather than part-time workers, as is the case in the West. Moreover, overtime working in most cases does not necessarily lead to an extra pay at high wage rates, as required by the Labour Law, whereas part-time working do result in pay reductions in terms of bonuses. This means that the flexible use of labour is increasingly linked to the efficiency gains of organizations. It is also pointed out that legal regulations regarding employment conditions have not yet been fully implemented at the firm's level, at least in non-state firms. As a result, management in the most firms studied takes advantage of weak legal enforcement, or the legal loopholes, to contain labour costs in the name of numerical flexibility. However, the firms studied in Shenzhen are subject to a stricter local government labour policy than their counterparts in Wuhan in hiring and firing of temps.

A striking contrast is found between the state and non-state firms in the choice of laying off vis-à-vis job quitting. While the state firms studied tend to use a lay off policy to downsize redundant workers due to the government support, while the private firms studied choose to use individuals-based dismissing and firing or induce individuals-based job quitting (voluntary, or encouraged leave) to wipe out "black horses" from the organizations. This difference in the choice of numerical forms between the state and non-state firms included in the study has much to do with the firm's age, which is linked to state ownership. Put differently, old state firms, due to their long-standing attachment to institutional legacies of the past, face immense difficulties in launching individual-based labour adjustment (e.g. encouraged leave), but have to resort to collective layoffs. Such a difficulty in the old state firms studied is indicative of the continuation of rigid employment relationships in the state sector.

Likewise, the five forms of functional flexibility practices as examined in the eight firms studied are mainly linked to, but not necessarily confined to, management's purpose for value-added of labour. These five functional flexibility practices are mainly sought among technical employees, managerial and administrative staff in the firms studied that are viewed as the core of the workforce from the management perspective. In other words, the core is a pool of the highly educated workers with firm-specific skills. Management needs to find ways to keep them from leaving, using self-managed teamwork, or incentive schemes to enhance workers' self-achievement.

Among the five functional flexibility practices examined at the workplace, job rotations and functionally contracting out of R & D are increasingly used in all the firms studied, with the goal of cost containment (e.g. job rotations) and/or technical-gap bridging (e.g. outsourcing). In most cases, job rotations are not always occurring on the bilateral level of different functional departments. Rather, job rotations are frequently linked to either punitive downward mobility (mainly in the state firms studied), or upward promotion (mainly in the private firms studied). Teamwork, job enrichment and enlargement are absent in all the state firms studied, while these practices are reported in the majority of the private firms studied, although limited to certain part of the core. Along with these functional flexibility practices (i.e. teamwork, job enlargement and job enrichment) are growing work pressure and more responsibilities.

Again, a salient difference is observed between the state firms and non-state firms included in the study in approach to outsourcing of the R & D, and job enrichment and job enlargement. In particular in the two private firms studied (PhS-4, and TeleS-2), top management is actively involved in attempting all forms of functional flexibility practices for added value of the core employees to organizations. Conversely, all the state firms studied, due to the four pointed constraints encountered, are reluctant to seek empowerment-oriented functional flexibility, or to change the management style. As a result, potentials of functional flexibility from the core workers are considerably restricted in the state firms, as compared to the private firms included in the study.

Based on flexible practices as summarized in Table 5.2 and Table 5.3, as well as actually applied to different segments of the workforce, relatively positioning of the eight firms studied are depicted in Figure 5.1[21], along the flexibility-rigidity dimension, and the state-private ownership dimension. The telecom firm TeleS-2 stands highest on the flexibility dimension of work organization. The pharmaceutical firm PhW-1 lies on the lowest level of the flexibility dimension near to rigidity. The other firms are scattered in somewhere between the two extremes. Firms selected from in Shenzhen seem more flexible than their counterparts in Wuhan, due to different local labour market conditions, and institutional environments. But, the private pharmaceutical firm PhW-4 situated in Wuhan exhibits obviously higher flexibility than the state firm PhS-5 in Shenzhen. Impacts of the industrial sectors on the organization's flexibility are manifested through the firm's location, age, and ownership. By and large, newly created firms (mainly in private ownership) are more flexibly than old state firms in work organization, using various forms of flexibility

[21] Although such positioning is a bit arbitrary, lacking solid quantitative data to justify, empirical findings revealed from this chapter have enough evidences for the depicting.

practices at the workplace.

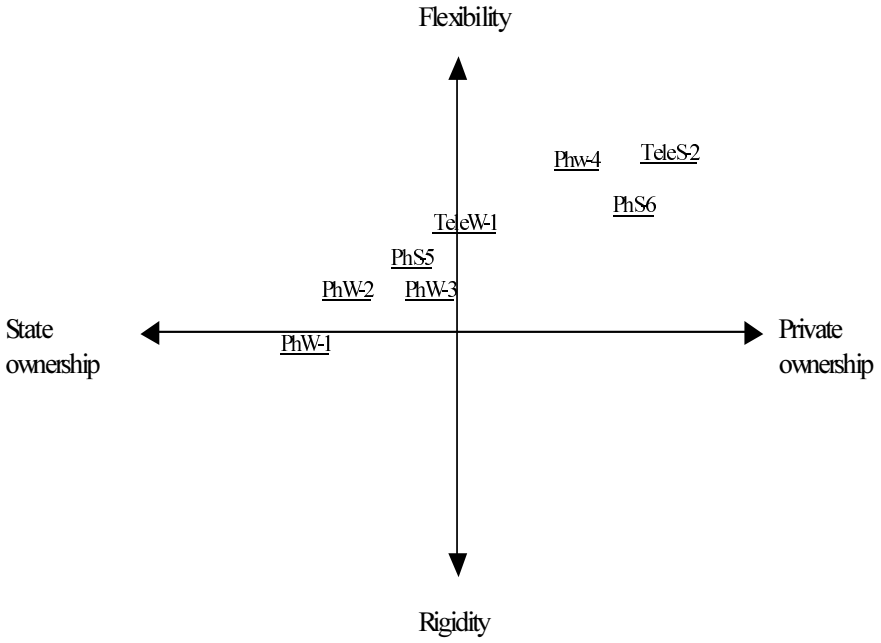

Figure 5.1. Relative positions of flexible work organizations

As often stressed in the Western management literature, the move towards flexible work practices actually involves changes in the design of jobs, greater complexity of tasks, higher skill levels of the workforce, the increasing use of team-work, growing delegation of responsibility to lower level staff, and improved communications throughout the company (OECD, 1999). The empirical findings in this chapter shown that most firms studied adopt flexible working time for production workers without much change in job design and task complexity, while using employee involvement with participation of lower level staff to improve motivation and commitment to the organization. However, for flexible work practices to be successfully implemented at the workplace, management has to change itself by playing an enabling role rather than a controlling role (Osterman, 1994b). As revealed in this chapter, labour flexibility is sought in the most firms studied without fundamental changes in management style, empowerment, and delegation of management responsibility. As a result, the extent to which functional labour flexibility has achieved is limited in all the firms studied, especially in the state firms.

From the transaction cost perspective, numerical flexibility attempted at the workplace points to the cost-cut strategy for achieving responsiveness and adaptability of labour to

changing product markets. This strategy is implemented in all the firms studied, and applicable to relatively low skilled production workers due to their substitutability in China's labour markets. Given an abundant supply of low skilled labour in China, management can hire and fire unskilled workers at its will, without the fear of business interruption caused by growing laobur turnover resulted from numerical flexibility pursued in the organization. Functional flexibility, as a value-added strategy, is mainly sought from the core workers that consist of managerial and technical staff. The core workers, due to their firm-specific skills to the success of the organization, management tends to explore their skills as much as possible by increasing their functional flexibility. In most cases, numerical and functional flexibility both are sought, and to some extent, achieved within the same organization.

However, alternative use of the two distinct flexibility practices (i.e. numerical and functional) towards different segments of the workforce at the workplace, particularly when applied to the same worker, can lead to moral hazards among the employees who feel exploited. As revealed in this chapter, job rotations often involve punitive downward mobility of the employees in the same organization. The so-called enriched or enlarged jobs are not to everyone's taste when demands for expected autonomy or greater tangible rewards, to compensate for the harder assignment, is not in sight. As revealed from this empirical research, job enrichment that essentially entails empowerment, as well as fundamental changes in management styles are far from reality in state firms. Hence, it seems less likely that the change of management styles, as well as empowerment, would easily occur in state firms.

5.5 Conclusions

Various forms of flexible working practices as examined in eight firms studied clearly show that Chinese managers are increasingly making use of labour flexibility practices to organize work at the workplace in response to the growing market pressure under the changing business environment. The two different flexibility strategies observed in the eight firms studied represent management's strategic choice in employing labour for cost-effectiveness, as well as for maximal utilization of their skills. Specifically, numerical flexibility is a strategy for reducing labour costs and increasing labour utilization by making more adjustable the volume of labour to fluctuations of production. This numerical flexibility strategy is mainly applied, but not confined, to the peripheral workers (i.e. the unskilled labour pool) that exhibit high substitutability. Functional flexibility is a strategy of exploring employees' skills and potentials by putting them on multiple work tasks within and between job boundaries. This strategy is mainly applied to the core workers (i.e. the skilled labour pool) whose supply is relatively rare on local labour markets.

A salient distinction is observed between state firms and non-state firms in approach to labour flexibility at the workplace. In the state firms studied, management has strong incentives to adopt flexible working practices at the workplace, but their efforts to do so are subject to various constraints, external and internal. Comparatively, in newly created private firms, management takes a proactive approach to labour flexibility, attempting various forms of flexible practices at the workplace. Eventually, the extent to which

flexibility achieved at the workplace is higher in private firms than in state firms included in this study, although a flexible employment relationship is increasingly observed in the state firms studied that replace employment rigidity prevailed at the workplace.

Another difference, and related to the above, is found between old firms and young firms in choosing various forms of flexible working practices for flexibly organizing work. Old firms, coincidently in the state ownership, harbored more workers than the productively required, and the workers are relatively old, with lower adaptability and mobility. Newly created firms, mainly in the private ownership, employ relatively young educated workers that exhibit great potentials for flexibility and adaptability. The attributes of the workforce in old state firms limit state managers in efforts to increase labour flexibility at the workplace, both numerically and functionally. Due to various constraints confronted, state managers (i.e. agent of the state) tend to resort to once-and-for-all laying-off practices to downsize the workforce on a large scale, with the government support (i.e. the principal). Moreover, the hierarchical style of management prevailing in state firms set limits on the penetration of functional flexibility practices (teamwork, job enlargement, and job enrichment) that entail empowerment and flattened organization structures. As a result, the scope of labour flexibility is considerably constrained in state firms, and the extent to which flexibility has achieved at the workplace is lower in the state firms than in private firms included in the study.

Local labour market conditions influence labour flexibility through the firm's access to temps, outsourcing, and skilled labour supply. As shown in the chapter, firms situated in Shenzhen exhibit higher labour flexibility than their counterparts in Wuhan. This is mainly due to well functioning loose labour markets in Shenzhen that provide its constituent firms with abundant labour supply, although strict regulations are imposed on the firms in the use of temps. In addition, the two different industrial sectors indeed have certain impacts on the scope and the specific forms of labour flexibility practices that the firm would otherwise to use. However, the industrial impact on the firm's labour flexibility is manifested mainly through the prevailing manufacturing technologies in each industry, as well as product market competition. And such an impact is not as significant as observed between two different local labour market conditions.

In short, the growing trend of adopting various forms of labour flexibility practices is observed in the eight firms studied as management has gained greater autonomy over the way the workforce is employed and utilized. The move toward labour flexibility actually involves a shift in the locus of work organization from permanent, stable collections of "jobs", to individualized, flexible employment defined by human capital portfolios. As a result, individual "flexible" workers are increasingly required to work on a flexible working time schedule, move between workplaces filling particular positions on demand, and even get dismissed when unneeded.

However, for the workforce to be flexible enough to buffer adverse market fluctuations, management has to cope with possibly the *adverse selection* associated with laying off, hiring, and encouraged leaving, especially in the private firms studied. In addition, flexible employment relationships may pose a risk to the firm's *relation-specific assets* (Williamson, 1981) as the rising labour turnover of skilled employees whose leave incurs a

loss of collective memory in the organization. Nevertheless, the combination of flexible labour practices implemented in the firms studied may represent the direction to which employment relationships will evolve elsewhere.

Another, but related, conclusion is that a set of flexible working practices adopted at the workplace is the result of management's choice of different governance structures for labour on relative transaction costs. This is so because there is always more than one course of actions in the use of labour that give rise to different costs and benefits to the firm. The choice of different forms of flexible practices can be understood as managerial weighing of the costs and benefits of alternative labour flexibility (or flexible work arrangements) under the changing business environment. As a result, various flexible work arrangements have applied to different segments of the workforce (mainly the core or the skilled labour pool, and the peripheral or the unskilled laobur pool) along numerical and functional dimension pointing to the two employment strategies: *cost-cut* versus *value-added*. However, these two contrasting employment strategies are simultaneously implemented in all the firms studied, with different focuses and goals.

Chapter Six

Consistency of HR Systems in Companies: Empirical Findings II

Introduction

In the preceding chapter, labour flexibility practices adopted at the workplace were closely examined in the eight studied manufacturing companies belonging to the two industrial sectors. For flexible work practices to be successfully implemented at the workplace, it is often presumed that the supporting HR policy and practice at the company (such as flexible contracts, differentiated tenure and salaries, training and promotion schemes) must be in place (Osterman, 1994b; Baron and Kreps, 1999; for the detail, see chapter 3).

This chapter focuses on human resource (HR) systems in the eight manufacturing companies, as related to workplace labour flexibility practices as examined in the preceding chapter. The purpose is to examine the presumed relationship or consistency between supporting HR systems and the successful implementation of flexible work practices at the workplace in the eight firms studied. The specific question to be addressed here is to what extent HR systems in the selected manufacturing companies have changed to support the adoption of flexible work practices at the workplace.

This chapter consists of three parts, after the introduction. The first part critically reviews HR systems in China's firms in transition, with reference to the recent discussion of the consistency of the firm's HR systems in the literature. This is followed by an analysis of empirical findings on HR systems and practices collected from the eight investigated firms in the fieldwork (part II). Discussion and evaluation of the empirical findings are made (part III). This chapter ends with concluding remarks (part IV).

6.1 Consistency of HR systems in transition

As stated in chapter 3, the firm's HR system is a set of distinct but interrelated policies and practices that are directed at attracting, developing, motivating, and maintaining a firm's human resources. These HR practices and policies need to fit together logically at the company level since they come to shape specific employment relations and incentive systems in the organization (Lado and Wilson, 1994; Miles and Snow, 1984). Often,

managers and firms make use of time contracts and differentiation in salaries to achieve higher mobility of unskilled workers whose supply is in excess in markets; while developing attractive schemes of training, promotion, tenure, and welfare benefits to keep skilled labour whose supply is scare in labour markets. In other words, the organization ought to craft HR policies and practices that are internally consistent and that suit its strategy, and technology (Baron and Kreps, 1999; Osterman, 1994b). The reason for the consistency proposition arises not purely from the technical benefits of internal consistency. It also concerns psychological perception and cognition of employment relationships, and social norms and justice of HR practices and policies. However, the firm's HR practices and policies are subject to industrial competition, legal regulations, and the institutional environment (Marginson et al, 1994). Often, HR systems are precisely systems "whose components sometimes work together and sometimes clash" (Baron and Kreps, 1999: 16).

In pre-reform China, as well as in other state socialist countries in the former Eastern European bloc, companies' personnel systems were part of state socialism institutions with internal logic of own and consistency based on the state plan (Grabher and Stark, 1997). In a typical state-owned firm (see chapter 2), state plans dominated the firm' production activities and personnel practices, while the role of markets was considerably circumscribed to an eligible margin. Workers were assigned into state firms according to state labour plan, and they were expected to stay in a single state firm for life. Enterprises' directors, who were appointed by local governments on behalf of the state, had *de facto* no say over personnel entry but accepted labour assignments from above even if the assigned personnel was unproductively required. Workers, once employed, were put in the life-time tenure, enjoying a wide range of welfare benefits, without the fear of losing jobs. A worker's wage was set by the state according to the eight-wage scales based on a complex criterion of seniority, skills, education, and employment status (Fan, 1994; Child, 1994). Training of employees for their skill improvement was rare, if at all, and most of such training was organized internally in the company run technical schools. When workers retired, they lived on the state pension until they passed away. Despite obvious flaws associated with the plan-based employment, personnel systems maintained an internal consistency of its own or congruent with the planned economy in which adherence to the state plans overwhelmingly overruled the cost-effectiveness of personnel activities (see the left side of Figure 6.1).

As China embarked on market-oriented transition since the late 1970s, the state plan-based personnel system was gradually transformed into one based on market practices (see chapter 2). In particular, the entry of non-state firms in the economy with their flexible HR practices challenged the state plan-based personnel systems in the state sector. In order to survive intensifying market competition and continue expanding, large state firms were corporatized, small state firms were contracted out to private hands (World Bank, 1996). Along with changes in firms' governance was transition of the HR policies and practices. Today, workers need to compete for employment to enter the firm from labour markets. Once employed, they are put on variable employment contracts instead of life tenure. Managers in state firms have acquired discretion over employees' wages and bonuses that both are linked to their performance. Skills of labour are emphasized both at the time of entry and compensation. Employees' training is being shifted to the firm and incorporated

into its human resource policy. Employment-related fringe benefits are cut off, or if there are any left, are being incorporated into reward systems. To a great extent, the state plan-based HR systems are being transformed into one embracing virtues of market practices (see the right side of Figure 6.1).

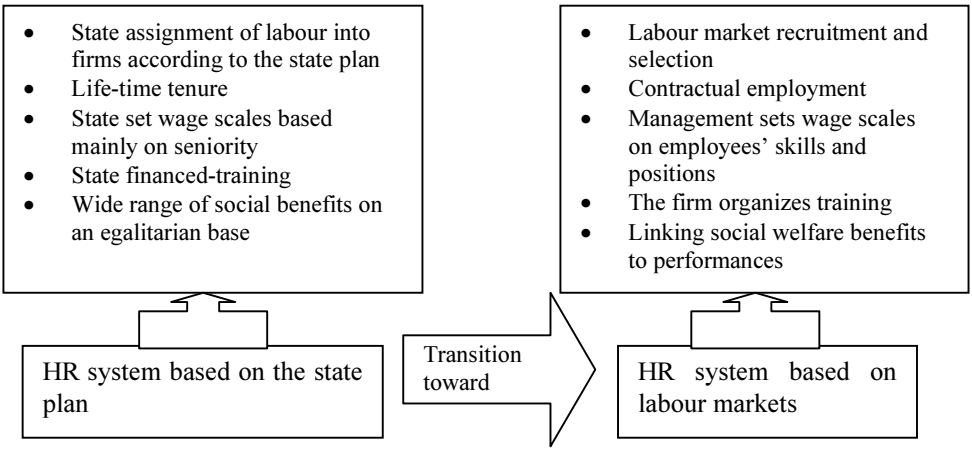

Figure 6.1. Consistency of HR system in China's transition context

However, in transition to the market economy, the company needs not only a market-based personnel system, it also needs an internal consistency of HR system at the company level. Despite many changes which occurred in the area of HRM (see chapter 2), some legacies of the old personnel system still remain in personnel management. It can be expected that inconsistency in HR systems arise most likely in firms where HR systems have been partially transformed, while the remaining is locked in the half way.

By referring to the consistency perspective discussed in chapter 3, this chapter aims to shed light on correlates of the company's HR systems and labour flexibility at the workplace in China's transition economy. The main question to be addressed here is how well the firm's HR policies and practices are internally complementary or consistent to enhance management's effort to increase labour flexibility. Put differently, to what extent have HR systems in the eight investigated manufacturing companies changed to support the adoption of flexible work practices at the workplace.

6.2 HR systems in the firms investigated: changes and continuities

The following analysis will highlight the company's HR system as related to flexible work practices as revealed in chapter 5. The empirical findings on HR systems were collected through case studies of the eight manufacturing firms belonging to the two industrial sectors (pharmaceutical and telecoms). The purpose is to examine whether the firm's HR

system has changed to facilitate or inhibit flexible work practices under the changed business environment.

Currently, HR systems in China's manufacturing firms concern five aspects of HR policies and practices: 1) recruitment and selection, 2) labour contract, 3) reward systems, 4) training and development, and 5) social benefits (Warner, 1995; Han and Morishima, 1992; Guanhaw, 1985). The presumed consistency of the firm's HR system is expected to facilitate management's ability to recruit from the external labour market, to develop workers' skills, and to prevent human capital losses and erosion. The five aspects of the firm's HR systems will be closely examined in sequence.

6.2.1 Recruitment and selection

In the HRM literature, recruitment and selection is seen as an important personnel tool that serves to bring in new qualified applicants into the organization's internal personnel flow cycle (Storey, 1995). By 'choosing right people with required skills', the organization can make difference, especially for the development of labour flexibility at the workplace. There are, however, substantial costs associated with hiring, and selection activities. Organizations usually have to expend substantial resources trying to hire employees whose skills and personal traits are well suited to the positions that need to be filled (Baron and Kreps, 1999). As a result, recruitment and selection constitute one of the most important HRM activities, usually performed by personnel specialists (or managers) in the organization (Lles and Salaman 1995).

Among the eight investigated firms included in this study, recruitment and selection activities fall in the personnel department (state firms) or human resource department (private firms) of the company (see chapter 4). As these firms studied move to recruit and select new workers from labour markets, some fundamental changes entail in *orientation*, *methods*, and *criteria*.

Orientation. In the past, recruitment and selection was subject to the sate labour planning, and performed by the government Labour Bureau, according to the state plans. Firms, especially state firms, could not freely recruit and select manpower from labour markets. The firm, when faced a personnel shortage, had to report to the local Labour Bureau for approval and then waited for assignment (Warner, 1991). There was no Western sense of recruitment and selection activities in state firms. The labour assignment practices through government agencies continued even long after labour contracts were introduced in the mid-1980s (Korzec, 1992). It was until 1992 that open recruitment and selection of new recruits on market became a rule in all types of firms, state and non-state (Warner, 1997, 1999; Ding and Warner, 1999).

The empirical findings from the eight firms studied confirm that all investigated firms have moved steadily away from state labour assignment practices, toward market-oriented recruitment and selection. The so-called market-oriented recruitment and selection includes: 1) hiring through a wide base of selection from labour markets; 2) different job positions are filled in on different market segments. Frequently, new production workers

are completely recruited from external labour markets, while managerial positions are not always exposed to market-based selection. Eventually, a great departure from the past is made in the state firms studied (e.g. PhW-2).

> **Case study PhW-2: Toward labour market recruitment and selection**
> In contrast to the past reliance on state assignment of personnel to the company, now job vacancy information is circulated among target universities before students' graduation in July each year, or through recruitment fairs organised by the local government labour agencies. The company participates in two recruitment fairs each year: one is *the campus recruitment* held in universities at the time of students' graduation; another is the *market recruitment fair* organised by the local government labour agencies. Through the campus recruitment, young qualified graduates are selected and attracted into the company; by the job marketing fair, experienced and skilled people are hunted out and employed. If manpower shortage cannot be met through the two ways, advertisement is sought via media such as on newspapers or TV. In 1997, the company recruited 50 salesmen out of 200 applicants through a strict written exam besides interviews.

Some salient differences exist between the state firms and the private firms investigated, with respect to labour market approach to managerial staff. In private firms, reliance on external specialist personnel markets (e.g. the Talented Exchange Market[22] in Wuhan, the General Talented Exchange Market[23] in Shenzhen) for high-ranking managerial staff or executives is often sought (e.g. PhS-6). This implies that private firms are more actively engaged in a market-oriented recruitment and selection.

> **Case study PhS-6: Reliance on markets for personnel inflow**
> The entry to the company (i.e. a newly created private firm in 1989) is open to all the qualified applicants. The ports of entry are not necessarily confined to the lowest ladder of each job category. Although senior managerial positions are promoted from within, with an emphasis placed on the length of services in the company, open recruitment applies to managerial job positions at the middle-level and below, via competition for filling in. Usually, competition for an entry into middle-level managerial job positions takes place on the local General Talents Market.

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[22] This is a specialized labour market segment created by the local government Personnel Department for supplying of technical personnel who possess a recognized professional title, or a college diploma or above. This personnel market is a so-called talented market distinguished from a low skilled labour market under the administration of local government Labour Bureau (see chapter 4).

[23] The General Talented Exchange Market was jointly set up in Shenzhen by the local government and the government Personnel Bureau in 1996. It is becoming a skilled personnel Exchange on which both the supply of skilled personnel and the demand are met and negotiated with terms of employment (see chapter 4).

By contrast, all the state firms studied continue to rely on the local governments or their agencies for the appointment of top managers, rather than on market-based selection. Even for middle or lower levels of managerial positions, open to market-based selection and filling in is very rare, and most times appointment through the above-mentioned supervisory agencies is applied. This restriction on the market approach to recruitment and selection of managerial staff undercuts the ability of state firms to develop flexibility among managerial employees. Even in the Sino-foreign joint venture with the state involvement (e.g. TeleW-1), top management members rely on the government for appointment, instead of on open selection. This signifies a strong impact of the government on the appointment of top management in corporatized state firms.

> **Case study TeleW-1: Hybrid form of recruitment and selection**
> As a joint venture, all new employees entering the company are recruited from labour markets on both local and national levels. To date, the priority of new recruitment is given to production workers, then to technical staff. Few administrative and ordinary managerial staff was recruited recently. Top management team members consisting of the general and two deputy managers are appointed by the Board on which the government holds seats. The China partner and the foreign investor take the general manager position every four years by turn. The present general manager is an American recommended by the foreign partner, while deputy managers are Chinese recommended by the government but appointed by the general manager. The chief engineer is an Indian, also appointed by the general manager.

Another striking difference between the studied state and private firms in recruitment and selection is that the state firms are occasionally forced to accept personnel assignment through the government as a political task, regardless of state firms' actual personnel needs. Such personnel assignment mainly applies to retired army men who finished military services, and the disabled who may otherwise hard find jobs elsewhere. Private firms are, however, not obliged to obey personnel assignment.

The remaining personnel assignment practices in state firms indicate continuity of old personnel system in the changed business environment. It also poses an obstacle on transforming of the state firm's HR system to market-oriented one with its own internal consistency. In particular for assigned personnel, once accepted, state firms cannot dismiss them at disposal. Obviously, the labour assignment legacy sets a limit to labour flexibility in state firms. It can also partly explain why redundant workers are hard to layoff in the state sector.

Besides, local labour market conditions strongly influence the firm's recruitment and selection. This is evident in Shenzhen, where migrant workers constitute the majority of local labour supply. But hiring of migrant workers usually encounters resident permit restrictions. This is so because the government imposes residence permit conditions on job applicants in order to curb the size of urban population (Mallee, 1994). In PhS-6, for instance, recruiting a new managerial job applicant without a regular residence permit must be reported to the local Personnel Bureau for the approval of an immigrant quota each

year. As a result, the company adds extra conditions such as high educational attainment and professional titles for exotic job applicants. Usually, job applicants with the university graduate level or a middle level of a professional title can easily obtain the government approval for immigration.

Despite the restrictive immigration policy in Shenzhen, local firms face loose labour markets. This is partly attributable to the prevailing higher wage rates in Shenzhen, as compared in Wuhan that attract a large number of migrant workers every year. Higher wage rates in Shenzhen essentially stem from Shenzhen's special status as one of the Special Economic Zones in China that allows firms to enjoy preferential tax policies over inland firms. As a result, firms situated in Shenzhen can take advantages of loose labour markets by pursuing discriminate recruitment and selection strategies towards different job applicants. In so doing, however, firms often face the problem of higher labour turnover (PhS-5).

> **Case study PhS-5: differentiated strategies of recruitment and selection**
> Hiring priority in the company (a newly established state firm in Shenzhen) is now given to attract qualified production workers and technical personnel from labour markets. This priority is formulated to cope with persistent high personnel turnover in these two groups, and to meet personnel needs derived from production expansion.
> The recruitment of production workers and technical personnel relies mainly on the local labour market. There is always a sufficient labour supply on the local markets of which migrant workers dominate job seekers. The firm can easily recruit new workers by just putting hiring information on the wall of their premises or on street bulletins. Hence, there are not so much costs incurred in searching and selection. For these types of job applicants, the company will not guarantee them a permanent residence permit that must be applied from the local government after recruitment.
> For managerial and administrative staff, labour turnover is relatively lower as compared to production workers and technical personnel. The turnover of managerial personnel is mainly confined to the lower ranking managerial employees with little hope of promotion. In general, managerial and administrative staff maintains quite stable in mobility. They tend to stay with the company for seniority-based promotion, or pay raise. As a result, the majority of managerial and administrative employees enjoy first-move advantage over the later comers in terms of wage rate, company housing, insurance, and promotion prospects in available management career ladders.

In short, the labour market approach to recruitment and selection enables firms' managers to select desired personnel from a broader source. In particular, the market approach has basically, although not completely, freed state managers from accepting the government's administrative assignment of personnel into their organizations. Despite this, contrasting approaches exist between the state firms and the private firms studied in the recruitment and selection of managerial personnel. While the former is still subject to management

appointment practice by the government, the latter relies on market-based selection of managerial personnel. Inconsistency of HR systems arises in state firms where the continued personnel assignment by the government contradicts with the labour market approach. Besides, local labour market conditions also affect firms' recruitment and selection policy toward the consistency, especially when the government imposes discriminate employment policies on migrant labour. Nevertheless, empirical evidences clearly show that market-oriented recruitment and selection indeed help management adjust the volume and the components of the existing personnel for the purpose of labour flexibility. The disadvantage pertaining to the labour market approach is that it likely gives rise to labour turnover.

Methods. A most common method used in the firms studied to select job applicants is through job interviews. Job interviews conducted in most of the firms studied are *unstructured*, rather than structured. Sometimes, a *panel* interview is applied in which the interviewee faces a panel of interviewers from related functional departments simultaneously (e.g. TeleW-1, TeleS-2, and PhW-2). Although the reliability and validity of job interviews vary substantially due to cognitive and evaluative biases involved by interviewers, a job interview at least provides the interviewer an opportunity to observe the applicant's verbal and nonverbal actions. Meanwhile, a job interview can facilitate the applicant's self-selection through so-called "realistic job previews", which "communicate the good and bad things about the job and the organization" (Baron and Kreps, 1999: 352).

Besides job interviews, direct psychometric and technical skill tests to job candidates are usually held to evaluate their fitness for particular jobs. In most state firms (e.g. PhW-2), a written test is held for a close examination of the applicant's skills, attitudes and qualities (i.e. competence) after the first round of interview. Basically, managerial and technical recruits are required to take a written test besides interviews, while production workers are exempted from a test. In TeleW-1, the foreign-invested joint venture, English language is included in the written test for managerial candidates. In the private firm PhW-4, a psychological test is held to all administrative and managerial candidates. This is so because the founder of PhW-4 was a former professor of psychology in a university. He knows the importance of psychological aspect of personnel in dealing with job stress.

Moreover, co-worker referrals are frequently employed, particularly in private firms investigated. Usually, hiring through such informal channels can result in savings on search costs, and enhance selection reliability (Baron and Kreps, 1999). Co-worker referrals presumably will also have a reputation stake effect on the success of new hires. This is quite prevalent among private firms, in which senior employees' recommendation for their acquainted friends, or classmates is sought as a source for some key managerial positions, such as accountants, and sales managers. It is assumed that referred friends, relatives, or university classmates by the incumbent for new recruits, can save on screening costs, or at least help enhance the reliability of selection (PhW-4).

Case study PhW-4: Co-worker referral system in recruitment

Job applicants recommended by senior employees or their friends or acquaintances are most welcome in the company, largely because this private firm was co-set up by a group of university teachers based on their

> friendships and trust. Co-worker referrals can save search costs while the reliability of such hiring is quite high. As the interviewed HR manager states frankly: "We encourage our employees to recommend their best capable friends to work in our company, even if there are no job vacancies available at the moment. We trust in their referrals because they want to do good for their friends as well as for the company. At least, they share risks as well as benefits with the company."

By contrast, the government supervising agencies occasionally recommend suitable candidates for key middle managerial positions (e.g. accounting manager) in state firms. The purpose is to minimize the widespread misconduct and corruption associated with some key functional positions in SOEs. In PhS-5, for instance, the accounting manager position was filled in by one of three candidates recommended through the top supervisory agency. This is reminiscent of the continuity of the administrative assignment of personnel into SOEs that prevailed in the past. What makes this differ is that personnel assignment is now restricted to key managerial personnel rather than general personnel, so does that the form it take in reference is not compulsory.

Criteria. In the West, employers sometimes screen on credentials of job applicants before offering employment. This is so simply because educational credentials can help employers to identify good potential employees from the applicants (Baron and Kreps, 1999). On the other hand, individual applicants, by showing the credentials, signify that they possess certain talents or skills that may be valuable to their prospect employers (Nordhaug, 1993; Murphy, and Topel, 1990). However, there have been debates on whether educational credentials reflect specific competence relevant to job performance of individuals (Osterman, 1998; Lazear. 1998). In practice, credentials, work experience, and age are always emphasized separately or in combination during recruitment and selection.

Empirical findings from this study reveal that Chinese managers use four main criteria in the selection of job candidates. They are *educational credentials, age, work experience, and residence permits,* as key criteria imposed on job applicants in all the firms studied. What distinguishes China from the West is that Chinese firms sometimes have to take job applicants' *residence permits* into account when offering an employment to non-locals. Just like work permits required for foreigners to work in the West, a job applicant's residence location really matters if he or she pursues a cross-region employment. This is so because the government still imposes the household registration for controlling cross-region employment migration.

First and foremost, *educational credentials* are particularly emphasized in all the firms studied, especially when job applicants are relatively young. In the private firms studied (e.g. PhW-4, and TeleS-2) certain levels of credentials are a primary condition for entry. Here, credentials are employed for screening off undesired applicants. Highly educated workers are likely to be able to learn new skills once employed. In addition, the educational makeup of an organization can help enhance the top managers' reputation in the eyes of key constituencies.

PhW-4: A diploma as a screening device
In principle, new production workers are mainly recruited from technical schools in possession of at least a technical skill certificate. Non-production workers are required to possess a university degree for an entry. Applicants aged over 50 are rarely considered giving an entry, except for those in possession of special skills. Applicants with a university degree aged 30 to 35 are most preferred if they have working experiences in the fields relevant to the company's business.

Age limit is imposed on new recruits in the time of selection, especially in private firms. The importance of a new recruit's age is straightforward. To a great extent, an applicant's age is roughly (but not always) indicative of one's adaptability, responsiveness, and flexibility. In TeleW-1, for instance, production job applicants aged over 25 will not be given chance for interviews. Similarly in TeleS-2, graduates aged below 25 are given a priority for the entry. From the management viewpoint, a group of younger employees represent vigor and vitality at the workplace. The younger workforce can be more flexibly employed than the aged one. In addition, younger employees have been less exposed to old rigid working habits prevailed in SOEs such as risk aversion, shirking, and absenteeism. Apparently, a younger employee is less likely to ask for an absence of sick leave and thus spend less on medical expenses. They also have more working years before they become pensioners. This is why the private firms studied have a relative younger workforce than the state firms on average.

Case study PhW-4: The role of age in recruitment and selection
As being a private company, it claims that female and male applicants enjoy an equal chance for an entry into the company at the time of recruitment. In practice, females dominate production workers, while males constitute a majority of managerial and administrative staff. No consideration is given to applicants aged over 50 for male and 45 for female. An average age of the workforce in the company was 28 in 1997.

Work experience is emphasized during recruitment and selection if the job applicant has a relevant education background while falling within the age limit set by the company. In PhS-5, for instance, Recruitment criteria for new workers and technical personnel include educational achievements (screened by diploma), work experience (screened by technical title or professional title), and age. For some job positions, a candidate's previous work experience is more valued than his education credential. For instance, production job applicants in PhW-4 must possess at least a high school graduate certificate, and aged below 30. Graduates from technical schools or vocational schools are preferred, and have an advantage if they had relevant work experience.

However, there are always conflicts among these three criteria when applying to a candidate simultaneously. Usually, the younger applicant who has rich work experience tends to have a lower level of education attainment since he or she might spend less time on his schooling education before employment. To deal with this dilemma, private firms often forego work experience and stress on educational attainment and age (see TeleS-2).

Case study TeleS-2: Recruiting excellent university graduates
In the company, the criteria used in recruitment and selection includes personality, potential capability, merit, education, and work experience, in addition to age limits. All these criteria are detailed into measurable variables that can be objectively assessed in a structured form. For different job vacancies, the criteria carry different weights against job requirements. In order to attract highly qualified university graduates into the company, top management has set up various forms of fellowships, and living stipends among top universities for excellent university students. Hence, the company has a very good image in society. In words of the HR manager interviewed, "our purpose is to recruit excellent university graduates."

Finally, a job applicant's *resident permit* plays a role in recruitment and selection. In most urban areas of China, people are not free to take jobs elsewhere as they wish. Non-locals without a local population registration cannot be employed locally unless they possess a residence permit on local labour markets. Although one's residence location does not always mean an insurmountable barrier on his employment in urban labour markets, it still carries a weight when firms choose among locals versus immigrants (Mallee 1994).

In both Wuhan and Shenzhen, locals always enjoy an employment priority over non-locals on local labour markets when other aspects held equal. It does not mean, however, that a cross-jurisdiction boundary recruitment and employment is impossible, but a cross-jurisdiction employment is costly and time consuming. This is especially true in the case of PhS-5 and PhS-6 located in the SSEZ where migrant workers make up 99 per cent of their total workforces. Hence, the local government has to impose strict resident permit control over firms to hire flexible labour forces (e.g. migrants, and highly skilled professionals) from nationwide sources, thereby setting a limit on labour flexibility.

Among the firms studied, recruitment and selection is mainly performed by the personnel department or the HR department, and subject to the direction of top management. But the role that the personnel manager (or HR manager) plays in recruitment and selection differ between state firms and non-state firms included in the study. In the private firms investigated, the title of HR managers is widely used, instead of personnel managers in most SOEs. Along with change in the title, the HRM department plays a role of an architect (or coordinator) in bringing suitable personnel into the company. This is reflected in the private firms studied where the HRM department usually involve in manpower planning, in addition to conducting recruitment and selection (e.g. TeleS-2, and PhW-4).

Case study TeleS-2: HRM department plays a role of architect
The HRM department is responsible for manpower planning, as well as recruitment in the company. Seeking and securing qualified personnel for the company is one of the central tasks of the HRM department, which can justify its existence. Recruitment is all year round activity that is open to job applicants nation wide. Large-scale new recruitment activities usually take place at the time of university students' graduation. At that moment the HRM department holds various forms of campus recruitment meetings

at target universities.

Case study PhW-4: intensive interviews and screening during recruitment and selection

As a newly created private firm on the green field site, the company saw an unconventional rate of growth at 300 per cent over the past three years. Therefore, it generates a manpower demand on a large scale each year.

In the initial phase of the firm's setup, the focus of recruitment was mainly on searching managerial and technical employees from local universities and research institutes. The method of the search was through headhunting in which individuals' networks played an important role. If specific personnel demands could not be met through this means, then advertise on the local newspapers applied. In the early phase of development, the company pursued a "*borrowing hens to lay eggs*" strategy by tapping idle production capacities in SOEs. Therefore, there was no need for production workers at the initial stage.

As the firm expanded at a fast speed, demand for a large number of new employees was generated. Reliance on individuals' networks could not meet manpower demands. Therefore, a specialized human resource department was set up in 1995 to take the responsibility for manpower planning and recruitment. Currently, regular recruitment activities take place all year around in order to secure qualified personnel. There are three sources for new entrants: 1) open recruitment on a large scale, followed up recruitment advertise on newspapers; 2) headhunting agencies; 3) personal networking.

The HRM department first comes up with new recruitment plans, in consultation with the relevant functional department short of manpower. Deputy manager in charge of personnel management takes a final decision regarding the size and requirements of new recruits. The concrete recruitment and selection activities are carried out by the HRM department, with the participation of relevant functional departments. Sometimes new recruitment proposals arise from the manpower planning projection that is deemed necessary in support of the company's annual development plan.

In the state firms studied, by contrast, the personnel departments do partake in manpower planning, which is the task of top managers. The role left for the personnel departments to perform is mainly of implementation. Very often, the personnel manager takes part in the first round of recruitment and selection, but the ultimate decision on new recruits remains in the hands of the top managers in charge of personnel in the company (e.g. PhW-3).

Case study PhW-3: Centralized decision-making and decentralized implementation

In the company, the personnel department is responsible for recruitment and selection. The procedure for recruitment is a two-way process: bottom-up proposing and top-down approving. Initially, functional departments come up with proposals for new recruits. These proposals are then submitted to the personnel department that makes a recruitment plan

according to the company overall manpower demands before reporting to the general manager for an approval. Thereafter, the approved recruitment plan is implemented by the personnel department, in collaboration with relevant functional departments.

To conclude, all the investigated firms have performed their recruitment and selection activities mainly on labour markets, meanwhile they are still facing some political constraints (e.g. assigning retired army men into state firms as political tasks) or institutional constraints (e.g. residence permits). The political constraints derive from the state ownership of firms, while institutional constraints stem from local labour market conditions in which migrant workers are discriminated against and restricted for employment.

The extent to which labour markets are approached, and the constraints managers faced distinguish the state firms from the private firms investigated in this study. The non-state firms studied tend to recruit all types of personnel from markets, which is supplemented by co-worker referrals. By contrast, most SOEs investigated still heavily rely on the local government for the appointment of managerial personnel above the middle level. Moreover, political attitudes remain one of the important factors in screening applicants at the managerial level in SOEs. Although the applicant's educational credentials, capability and working experience are more important factors to be considered for key personnel positions in SOEs, a good political posture, e.g. being a member of the Communist Party does add an additional advantage.

Another striking difference lies in the role of the personnel or HR departments between state and non-state firms in the area of recruitment and selection. The private firms studied assign an important role to HR managers and HRM departments in attracting and bringing qualified personnel to organizations. Comparatively, the role of the personnel manager and the personnel departments in most state firms studied are suppressed to be one of an administrative clerk, lacking basic decision-making authorities in the field of recruitment and selection. These differences would be manifested themselves in other related areas of personnel affairs, inevitably influencing labour flexibility at the workplace.

Table 6.1. Recruitment and selection: Changes and continuities

Properties	**Comparison**	
	State socialism	*Transition economy*
Orientation	State labour plans	Labour market approach
Methods	Government labour assignment and administrative appointment	Firms' interview, testing, co-worker referral, plus government appointment
Criteria	Resident permit, education attainment, political performance	Educational attainment, age limit, work experience, resident permit

Despite the above differences, some similarities are observed in recruitment and selection methods preferred between the state firms and non-state firms included in the study. For instance, both the state and non-state firms tend to recruit first line-workers from external labour markets. Such external labour market recruitment and selection activities are performed through various job-fairs, and campus recruitment. There is also a convergence between state and non- state firms in terms of criteria and procedure used in recruitment and selection. All the firms studied emphasize job applicants' education, work experience, and age. They also use job interviews and oral/written tests, even psychological tests in the selection process (see Table 6.1). Inconsistency arises in state firms where government continues to appoint top management, a practice that is contrary to market-based selection principles. Nevertheless, labour market approach provides management with an important tool in attracting desired personnel into the organization. The remaining political or/and institutional constraints set a limit to management's effort to increase labour flexibility.

6.2.2 Flexible labour contracts

Labour contact is a starting point of employment relations that specify rights and obligations of the contracting parties (i.e. the employee and the employer) following-up recruitment and selection. Twenty years ago, a labour contract was completely foreign to Chinese people, while it is now widely used in all firms in today's China (see chapter 2).

A labour contract is a set of statutory regulations that covers all aspects of employment relations. It reflects particularly industrial relations that are subject to broad institutions, and legal systems. However, "employment is often an open-ended transaction, with the details of the transaction specified only as time passes and relevant contingencies arise" (Baron and Kreps, 1999: 62). Usually, a worker tends to enter is long-term employment as long as the expected wage grows over time. While an employer willing to offer a long-term contract to a worker only if investments in the long-term employment relationship will be paid off over employment. Behind mutual expectations for a long-term employment relationship is reciprocity of the contracting parties' commitment to each other, which is as well grounded upon their reputation as related to trust and sunk investment (Hart, 1984; Kreps, 1996). In particular, different employment governance (*spot market*, *obligation market*, *primitive team*, and *relational team*) should be assigned to employees who differ in skill specificity and their contributions to the firm's performance (Williamson, 1981; see chapter 3).

Empirical evidences from the eight firms studied reveal that labour contracts are applied to workers across the organization. The length of contracts applied varies with firms and differs among the workforce. The state firms studied tend to offer varying lengths of contracts to employees based on their seniority and skills. The private firms studied, in contrast, tend to offer a unified length of labour contracts to their employees based mainly on skills or employment positions. Moreover, like conventional practices prevailing in the West, a probationary period applies to new recruits in all the firms studied before formal contracts are offered (see Table 6.2).

Table 6.2. Summary: aligning the length of contracts to individual employees in the eight firms investigated, (1997)

Contract / Firms	>10 years	3-5 years	3 years	1-2 years	1 year
PhW-1 (SOE)	Incumbent employees with a service of more than 10 years	Senior employees with 5 to 10 years service; Newly recruited university graduates after 6 months probation	Newly recruited production workers after 12 months probation		
PhW-2 (SOE)	Incumbent employees with more than 20 years service	Senior employees with less than 20 years service			Newly recruited employees from 1997, after 3 months of probation
PhW-3 (SOE)	Incumbent employees with more than 10 years service	Key technical employees with 5-10 years service; Newly recruited university graduates			Newly recruited production workers from technical schools or colleges after 3-6 months of probation
PhW-4 (Priv.)				Non-production staff is put on two-year contracts, while production workers on one-year contracts after 3 months of probation	
PhS-5 (SOE)			All employees put on three year contracts after 3 months of probation		
PhS-6 (Priv.)					All put on one year contracts after 3 months of probation
TeleW-1 (SFJV)				Two-year contract applies to all; while senior managers enjoy *ad facto* permanent employment; with 3 months of probation	
TeleS-2 (Priv.)			Managerial and professional staff in R & D after 3 months of probation		Production workers, & maintenance staff, after 3 months of probation

Note: SOE—state-owned enterprise; Priv. -- private ownership; SFJV.— Sino-foreign joint venture

Table 6.2 clearly shows that the longer the worker stays with the firm, the longer the contract. And the higher the worker is educated and skilled, the longer the contract. Frequently, production workers are put on short-term labour contracts, while managerial, technical, and administrative staff members are offered relatively long contracts. Another significant feature pertaining to varying lengthy labour contracts is that newly recruited employees are often given even shorter contracts upon the initial entry than are those who have already entered. Apparently, different lengths of employment contract apply to employees, and the subsequent employment relationships evolve, indicate management's strategic considerations of costs and benefits of the alternative employment governance with respect to employees' skills-specificity and performance measurability.

In comparison, the state firms studied offer longer contracts to their employees than do private firms. However, state firms do not provide all the employees with the same length of contracts. Instead, the length of contracts varies with employees' seniority or their employment positions in state firms. Hence, relatively long contracts are not identical to all the employees within the same organization. Similarly, probationary periods of newly recruited employees range from 3 to 6 months. One extreme case is the state firm PhW-1 where one year of probation is applied, double the trial period of half a year set by the Labour Law, to newly recruited production workers.

> **Case study PhW-4: Segmental differentiation by length of contract**
> In the company, all the employees are hired on contract, regardless of their job positions and working locations. Newly recruited employees are subject to three month of probation before getting a formal labour contract. There are two types of labour contract distinguished by the length, and applicable to different categories of employees: 1) two year period of labour contract mainly is applied to managerial and technical personnel and administrative staff, and 2) one year period of labour contract to production workers and salesmen. Labour contracts of any type can be renewable conditionally on the individual's performance and the need of the company. In principle, the company pledges no layoff policy toward employees unless one gets her/himself sacked due to her or his under-performance specified in the contract beforehand or the violation of labour discipline in the company.

In particular, old state firms offer relatively long-term contracts to their workers (such as in PhW-1, PhW-2, and PhW-3), as compared to newly created firms included in the study. One plausible explanation is that old state firms have to comply with the Labour Law by giving longevity employees relatively long-term contracts. However, this points to the fact that the bulk of the employees in state firms are relatively old, and they have spent long period of their working life in the same state company without mobility in the past.

> **Case study PhW-2: Long-term versus short-term contracts**
> Like other state-controlled joint stock companies, every employee in the company is required to sign a labour contract with the general manager acting as a legal representative of the company. The length of labour contracts corresponds to service years in employment life regardless of organisations where an employee worked in the past. For those with a

length of services of over 20 years before 1997, an over 10-year work contract would be offered, which surpass the required maximum 10 year services set out in the *Labour Law*. By this standard, long-term labour contract holders accounted for 60 per cent of the workforce in 1997. For those worked for less than 20 years before 1997, the medium-term of 3 to 5 year labour contracts could be concluded. In practice, medium-term labour contracts are mainly given to those core employees with technical titles or college diplomas (such as foremen, middle managers). Short-term labour contracts of one year mainly apply to all the newly recruited workers graduated from technical schools.

Case study PhW-3: Seniority and skill level in contracting
Beginning in 1995, all the existing employees were converted into contract workers for a fixed length. The length of employment contracts for each employee differs, depending upon years of service that the employee consecutively stayed with the company in the past. The maximum ten years of labour contracts applied for those with over 10-year services in the company. Other factors such as skills, education, and task responsibilities are also taken into account in determining individuals' labour contract duration. Key technicians and managerial employees are given relatively longer contracts of over 5 years. Ordinary workers are normally offered a short period of contracts varying from 2 to 5 years, depending on their years of services and their skill levels.
Newly recruited production workers are put, after 6 months of probation, on one-year lengthy contract renewable conditionally. For the newly recruited graduates from universities, 5-year lengthy contracts are offered after 3 to 6 months of probation.

Obviously, long-term contracts in state firms are occasionally used as a managerial tool to retain key competent employees in response to the increasing labour turnover after economic reforms. From the transaction cost perspective, particular governance should be designed to cater an employee with idiosyncratic skills that were developed over time in the firm. Long-term contracts offered to technical personnel in some state firms can be roughly seen as management's attempt to consolidate the '*relational team*' type of employment relationships (Williamson 1981:565). Following this logic of reasoning, it can be argued that varying lengths of employment contracts reflect management strategic considerations in coping with *adverse selection* problems arising from the growing turnover of contracted labour in the organization.

Usually, a long-term labour contract implies lower numerical flexibility since it seems to restrict management's effort to adjust the volume and components of labour in a short time. The resultant lower numerical labour flexibility may be further reinforced by the lower degree of mobility of the employee with firm-specific skills and bondage developed under the long-term contract. However, functional flexibility can be developed under a long-term labour contract in which a flexible staffing of the employee across functional departments for multi-skill learning is most likely. In addition, a long-term contract represents commitment of both the parties to the enduring employment relation, such as the case in

the large Japanese firms. In this respect, the state firms studied (such as PhS-5), by giving employees relatively long period of contracts set a limit on numerical labour flexibility while assuming a potential for functional flexibility. Conversely, private firms (such as PhS-6) tend to offer employees short-term contracts that allow for numerical labour flexibility in the main.

Case study PhS-5: Unified contract length and labour turnover

Although the employees can be distinguished between local employees and non-local employees (i.e. migrants) in terms of residence status, or between production workers and non-production workers in terms of labour division, they are all contract employees with the same duration of three years in the company. This means that every employee, regardless of his job positions, need to sign a labour contract with the company for a fixed period of three years, which are renewable conditionally on the need of the company and the performance of individuals upon the contract expiry. In addition, collective contract is concluded between employees as a whole represented by the trade union and the general manager that cover the terms of employment, working hours, working conditions, and others concerning labour rights and interests.

Newly recruited employees are subject to a probation of three months before a labour contract of three years can be obtained. The similar length of contract applying to all types of the employees is to reduce increasing mobility and labour turnover that often disrupt the company's continued business operations. In spite of relatively long term contract offers to employees, labour turnover (outflow and inflow) remains as 60-70 per cent of the total employees. The most mobile employees are those technical personnel, production workers in production plants, and employees in the service sectors. While the managerial and administrative personnel remain stable with a lower turnover. As the general manager assistant expressed, the primary reason for growing job quits is a high wage rate elsewhere. Job quitting is rising among young and highly educated employees who have more employment opportunities in Shenzhen. Another driving force for high labour turnover lies in the widening wage gap between the well rewarded managerial and administrative staff who tends to stay and the insufficiently paid technical and production workers who tend to leave.

Case study PhS-6: Short-term contracting and flexible labour adjustment

All the employees are hired on a contract base, with duration of one year, regardless of their positions and statuses in the company. Newly recruited employees have a probation of three months before a formal contract can be concluded. As set out in the labour contract by the Labour Law, the company has rights to fire new employees during the probation without any compensation. Hence, highest turnover occurs in the period of probation. This does not mean that the company is abuse of labour during the probation. Rather it is because an abundant supply of migrant labour on

> local labour markets, so that there is little cost incurred in hiring new ones in the place of leaves. Short-term contracts allow the company to do so.
> Individual labour contract of one year can be renewed upon the conditions of individuals' performance that is evaluated by a foreman or department manager twice a year, as well as the need of the company. In case the contract is not renewable, a certain amount of compensation is paid to the employee who is bound to leave, according to the labour law. In general, workers leave the company because of their violation of labour discipline, or poor performance that fails to meet the required job quota. And the majority of leaves are voluntary simply because they find a good job elsewhere. Hence, the short-term behaviour characterizes workers.
> For the managerial and technical employees that are normally perceived as the core of employees in the company, one-year period of employment contract applies too, and is renewable in most cases. For this category of employees, their employment contracts of one year are tied to the scheme of stock options based on the length of service in the company. Therefore, there is an incentive for them to stay with the company as long as possible. Turnover is thus relatively low among senior managers and engineers than other lower levels of employees. The managerial and technical employees (i.e. the core) are subject to a strict performance appraisal stressing on commitment that is different from one applied to production workers. Each department manager conducts the performance appraisal of managerial and technical staff in collaboration with the HRM manager twice a year.

Most noticeable findings are found in the two telecom firms studied where the length of labour contract is tailored to different segments of the workforce, for the purpose of increasing (numerical and functional) flexibility in the organization. In TeleS-2, for instance, individual labour contracts vary sharply between different categories of employees: the core employees (mainly managerial, marketing staff, and R & D professionals) are offered relatively long contracts of three years, from which enduring employment relations are anticipated, and functional flexibility is expected. The remaining employees (mainly production workers, and auxiliary administrative staff) are offered one-year contracts that are renewable conditionally.

In the joint venture of TeleW-1, middle- level and above managers enjoy *ad facto* permanent employment privileges (but not permanent managerial job positions), while the remaining employees are all put on contracts of two years in length. The primary purpose of granting a permanent employment status to managers above the middle level is to minimize the turnover of key employees likely occurring with variable contracts. Another purpose is aimed at developing multi-skills of the permanent key employees across the company in the hope of functional flexibility. In either case, stringent performance appraisals are imposed on those employees with relatively long-term contracts. It is claimed that the strict performance appraisals serve as a countervailing mechanism through which free riders and poor performers are encouraged to resign.

Case study TeleW-1: Middle managers: permanent employment and changeable managerial titles

Middle managers and senior managerial staff enjoy a permanent employment status. They work under huge pressure under the management responsibility system accountable in their functional departments. In case a department manager could not fulfill an assumed responsibility specified in advance in a contract with top management, he will risk losing his managerial title, or replaced by other qualified candidates from within the company. The department management responsibility combined with annual assessment is accompanied by another paired HRM policy of promotion from within. That means all the qualified personnel enjoy an equal chance of being promoted by his performance in the company. In this way, a career development ladder is opened to each employee, especially for managerial and technical employees

A two-year lengthy contract applies to all the remaining employees. There is no difference in the length of labour contract between production workers and non-production employees. The short-term contract of two-year period, coupled with the annual individual performance appraisal conducted by the head of department, exercises sufficient pressure on employees for hard work and high commitment. High wage rates (i.e. 10 times higher than the local average) remind the employee in the company of how costly if he loses a job due to shirking in daily work.

In summary, the contractual employment system has been implemented in all the firms investigated, and covers all types of employees. The length of individual labour contracts, however, varies with firms and differs considerably among employees with different skills. In general, the state firms studied, coincidentally old firms, tend to offer relatively long-term contracts to their employees based on seniority. Comparatively, employees in non-state firms are offered relatively short-term contracts that are more or less simply or in uniform. Despite the difference in length and complexity, core workers, especially senior managers, and technicians in both state and non-state firms are well protected by relatively long-term contracts, and from which functional flexibility and enduring employment relationships are expected. In particular in the foreigner-involved joint venture (i.e. TeleW-1), top management teams are offered permanent employment status but not enjoy permanent managerial positions.

Referring to Williamson's (1981) four forms of employment governance, special governance structures are needed to protect firm-specific investments while minimizing transaction costs incurred repeatedly in contractual relationships. In practice, employment relationships are often open-ended transactions, the length and the nature of employment contracting depend much on the value of employees' skill specificity that accrues to the firm over time. As revealed from the above empirical findings, a relatively long-term contract is given to workers with firm-specific skills or key functional positions in both state and non-state firms included in this study.

From the transaction cost economics perspective, variable contracts in the firms studied, plus variable probationary lengths, help management to get rid of redundant workers,

remove problematic employees, and redefine management-labour relationships. Increasingly, management put key employees defined by skills or managerial positions in the protective governance of the long-term contract, while unskilled employees, and migrant workers are left in the short-term contract, whose skills are non-firm specificity and can be easily obtained on markets. Obviously, the underlying economic foundations of the varying labour contract realities revealed from this research are transaction cost economics of alternative employment relationships, subject to management's cost and benefit considerations, and echoing Williamson's (1981) four employment governance model.

However, some inconsistency in HR systems remains in some of the state firms studied. For instance, in PhW-1, PhW-2, and PhW-3, old employees who have been with the firms for most of their life are put in relatively long-term contracts based on seniority, instead of on skill-specificity. Newly recruited workers (included university graduates) are offered relatively short contracts. Such inconsistency in the employment contract policy would signal to young skilled workers the idea of leaving due to their flexibility and higher employability elsewhere.

6.2.3 Reward systems and compensation practices

Reward policies and practices constitute an integral part of the firm's HR system that need to be flexible enough to support labour flexibility at the workplace (Osterman, 1994b). The essence of all flexible compensation measures (such as profit-sharing, bonus, employees ownership schemes) is to seek a close link of rewards to a group or individuals' performance and work efforts. By forging a close link between pay and individuals' effort, the flexible reward system is expected to promote intrinsic motivation among employees who align their individuals' goal to that of the organization (Baron and Kreps, 1999). Although performance-related pay involves a wide range of complex pay measurement difficulties (e.g. individual-based versus collective-based, or inputs versus outputs) (Williamson, 1981), a crucial question is how to reward employees completely and sufficiently so as to diminish effects of the typical *principal-agent*, and *free-rider* problems.

Empirical findings on reward systems and compensation practices from the eight firms studied are summarized in Table 6.3. Here, the focus of the analysis is on whether the prevailing reward systems in the firms studied have become flexible to support flexible work practices at the workplace. Two key points are addressed in the following: specific forms of rewards, and grounds on which compensations are based.

As pointed out in chapter 2, reward systems in pre-reform China were characterized by egalitarism that discouraged workers' motivation and productivity (Warner 1995). Two-decade economic reforms have established performance-related reward systems in the state sector. The old eight-level wage-grade system was abandoned nationally after 1992, and replaced with the new 'post plus skill' system instead (Goodall and Warner, 1997). As state enterprises were granted increasing autonomy to determine their reward systems and were allowed to fun wage increases from their retained profits. They were required to keep

the growth in total payroll of the enterprise lower than the growth in its profits, and the growth in employee's actual income lower than the growth in productivity (so-called *two lowers).* The 1994 Labour Law further institutionalized enterprise's authority over rewarding employees in the light of their performance and the firm's profitability.

Table 6.3. Reward systems and compensations in the eight studied companies, 1997

	PhW-1 (SOE)	PhW-2 (SOE)	PhW-3 (SOE)	PhW-4 (Priv*.)	PhS-5 (SOE*)	PhS-6 (Priv*)	TeleW-1 (Jovt*)	TeleS-2 (Priv.)
I.Reward systems								
•Basic wages	+	+	+	+	-	-	-	-
•Post wages	+	+	+	+	+	+	+	+
•Service wages	+	+	+	+	-	-	-	-
•Bonus payment frequency	Annual	Montl.	Annual +Montl	Annual+ Montl	Annual +Montl	Annual +Montl	Annual	Montl.
•Stock options & the coverage	All the employ -ees	All the employ -ees	All the employ -ees	The core worker	The core	The core	-	The majori- ty
II.Compensation bases								
•Skill	+	+	+	+	+	+	+	+
•Status (or position)	+	+	+	+	+	+	+	+
•Performance	+	+	+	+	+	+	+	+
•Seniority	+	+	+	-	-	-	-	-
III.Average annual Wage income (in RMB yuan)	6,300	9,000	7,100	20,000	36,000	36,000	96,000	120,000

Note: "+" stands for the presence; "-" stands for the absence; "*" denotes the presence of foreign investors.

Table 6.3 clearly shows that the reward practices and scales are neither unitary nor identical among the firms studied within and between the two industrial sectors. In the telecom sector, two investigated telecom firms (TeleW-1 and TeleS-2) apparently stand at the highest reward scale, which overshadow all the investigated pharmaceutical firms situated in the same cities (or labour markets). The strikingly high level of compensations in the two telecom firms can partially be attributed to industrial rents inherent in this newly growing high tech industry (see, indicators of profit and tax in chapter 4). Not surprisingly, both the firms assert that the extremely high scale of salaries comes from higher labour productivity. Underlying the higher compensation practices in the two telecoms firms is the *effect of efficiency wages* at work in China. In other words, higher wage rates over the market average attract best employees, who have to fully commit themselves to their jobs.

In the pharmaceutical sector, scales of compensations (absolutely or relatively) are relatively low, as compared to the telecom firms studied. However, a distinction in compensation is evident between the group of state firms where lower pay prevails and the cluster of private firms offering higher wages. The difference in reward scales between the two aforementioned groups cannot fully be ascribed to the nature of ownership alone, although important in determining the scale and forms of payment in the state sector. Rather, the difference in rewards has much to do with the age of the firms, equally

important, if not more, with the firms' location.

In particular, the two firms (i.e. PhS-5 and PhS-6) located in SSEZ differ completely in ownership but share many common in their reward systems and compensation practices. The identical form and scale of compensation among the both firms with different forms of ownership at SSEZ indicate the effect of isomorphism of local labour market competition at the workplace where workers have to be rewarded in the same manner and at comparable rates. A convergent trend in compensation isomorphism is further confirmed from the other four firms situated in the same inland city of Wuhan, where reward systems and the bases of compensation look more similar than different.

Taking the three old state pharmaceutical firms (i.e. PhW-1, PhW-2, and PhW-3 located in Wuhan) as a group, and other three newly created firms (i.e. PhW-4, PhS-5, and PhS-6) as an another group, striking similarities can be observed among firms in each group in terms of compensation bases and the scale. While the three old state firms studied have to comply with the state wage guidance (i.e. employees' rewarding and compensation must be in line with profitability of the organizations), the newly created firms (both state and private) are enjoying much more freedom in sufficiently rewarding and compensating their employees. Again, firms' location, as well as their age, makes difference in the level of rewarding, which is, in turn, related to the performance of firms in terms of profitability (see chapter 4). Though contrasting difference in compensation between the two groups of firms distinguished by age, reward systems and compensation practices in all the firms studied have become flexible in that employees' rewards are floating with their employing organization's performance.

Under a close examination, a shift toward flexible reward systems and compensations is steadily under way in all the firms studied. For instance, all the state firms studied have moved away from the past unitary reward systems, under which seniority and employment statuses determine wage scales set by the state. Instead, they are all moving toward the post wage systems that are mainly based on skills, job positions, and performance.

> **Case study PhW-3: Flexible wage systems**
> The company adopts a structural wage system made up of basis wages, post wages, service wages and subsidies. The scales of the basic wages are set according to the state wage guidance that takes into account of education and technical qualification of employees. Currently, basis wages (around RMB 200 yuan) make up 30 per cent of monthly salaries, equal to or above the minimum wage set up by the local government. Post wages account for 60 per cent of employees' monthly salaries, and are based on workers' skill levels or their professional titles (i.e. managerial and technical titles). Service wages are seniority-based, applicable to each employee, with RMB 2 yuan /year for the first 20 years of service, and 3 yuan/year for additional year beyond. Besides wages, there are certain allowances in forms of medical subsidies, housing subsidies, transportation subsidies, and newspaper subscription that are both seniority- and post-based and varies with years of service.

In addition to regular wage payments, employees receive monthly bonus payments that are linked to individuals' performance on a comparable base. Moreover, year-end bonus payments are available to all employees and contingent on profits of the company earned. Managerial staff generally enjoys higher rates of year-end bonus payments than workers, proportional to their hierarchical status in the organization.

Case study PhS-5: Merit-based rewarding systems

The company's reward systems consist of three components: post wages, bonuses, and subsidies. Like other SOEs, post wages are based on the employees' educational attainment that can be converted into either an administrative position (for managerial personnel) or a professional title (for technical personnel) in each job ladder within the organization. While production workers are differentiated from each other by skills in line with their post wages. Post wages account for 70 per cent of total compensation for employees per month.

Employment allowances consist of medical and housing subsidies. Both the subsidies are incorporated into the employee's monthly wage payments. The amount of subsidies varies with length of service and job position in the company. From 1995, the company provision of medical allowances was ceased, instead, each employee received a certain amount of medical insurance and a pension paid by the company, but governed by the external government specialist social security agencies. In addition, the company contributes a certain proportion of the aggregate wage bill to its employees' pensions, medical expenses, and housing funds. These funds are then allocated into each individual's account or insurance card, coupled with the relevant amount deducted from one's monthly wage bill. Only contract employees are entitled to socially pooling insurance programs. Employees without a labour contract, or on probation, are excluded from such social security schemes. In effect, social security programs extend selectively to cover most managerial and administrative staff and some key employees that are perceived as the core employees in the company, while the majority of production workers and junior technical personnel are excluded as well. Accordingly, labour turnover is higher among these groups.

The priority of wage compensation in the company is given to the core employees in key functional departments such as financial management, marketing and sales, technical maintenance. In addition to cash compensation, there are stock options only open to key employees. The purpose of stock options is to retain the key employees in the company and discourage them to leave.

In 1997, average annual incomes compensated to employees reached RMB 36,000 yuan. Internal wage differentials were modest among the managerial personnel, with senior managers receiving salaries 70 per cent more than juniors, and managers 70 percent higher than the managed. The modest wage differentials among managerial personnel have something to do with the ownership of the company as being a state-owned by stressing

individuals' contribution rather than rewards. However, a wide wage differential exists between managerial employees (i.e. core personnel in the company) and production workers, with the former receiving five times more than the latter in monthly wage payments. The majority of the production workers are migrants who have not got a permanent residence permit and who are insufficiently rewarded. This is why a higher mobility is most found among production workers who are wage takers on local markets. The frequent mobility of workers curtails their lengths of services in the company, thereby disqualifying them in access to stock options, and other social security nets.

In the old state firm PhW-3, seniority- and status-based compensations are still present, but carrying minor weights in reward determination. Usually, seniority-related compensation (in the form of service wages) is mainly associated with subsidy payments such as medical allowance prevailing in other elderly state firms (e.g.PhW-1). This is in contrast with private firms (i.e. PhW-4, PhS-6, and TeleS-2) or the newly created state firm (PhS-5) or the state involved joint venture (e.g. TeleW-1), where seniority loses its credit in reward considerations.

Moreover, the *basic-wages* and *service-wages*, which are absent from the reward components in firms at SSEZ, constitute part of the employees' compensation of firms in Wuhan. Yet, there are significant changes in the format of basic wages and service wages in that these two types of compensation are fixed. The total scale of the both wages is increasingly equivalent to the level of the minimum living expenses, or minimum wages, as set by the local government (e.g. PhW-1).

Case study PhW-1: Towards flexible compensation

The company currently adopts a structural wage system that consists of basic wages, post wages, seniority wages, and some subsidies. The basic wage is fixed part of the monthly payment around RMB 200 yuan for every employee. The basic wage should, in principle, exceed the minimum wages (or a guaranteed necessity living expense line of RMB180 yuan in 1997) set by the local government on a year base. The post wage is valued in light to skill levels of production workers, or professional titles of staff (including technical and managerial staff). It is assumed that these skills or professional levels[24] of employees match the corresponding tasks or responsibilities. The post wage serves as a screening of performance-related payments that differentiate among the workforce. Seniority wage is related to the years of service in the company, with RMB 2 yuan/year for the first 20 years of service, and RMB 3 yuan/year for every additional year in excess of 20 years. Other miscellaneous payments contained in the wage payments include both seniority- and post-based subsidies ranging from subsidies for medical expenses, housing funds, to newspapers

[24] Skill levels or professional titles are assessed and recognized by specialist assessment institutions that are authorized to issue officially recognized technical certificates to technical persons and professionals.

subscription (only available for professional staff). For instance, RMB 10 yuan of the medical subsidy is incorporated into monthly wages of the workers with the service of 10 years. The maximum of all the subsidies is set at RMB 30 yuan for the longest serviced employees. By incorporation of medical subsidies into employees' wage payments, the company can economize on expenditures squandered by state employees under the free medical-care system. In case the employees need an in-hospital remedy, the employees have to pays 20 per cent of the hospital expenses. The company will claim the remaining expenses.

The principle of compensation is based on performance, coupled with merit considerations as well as a minimum living expense security. In general, young production workers enjoy relatively higher annual earnings than the old under a piece rate, while technical and managerial staff enjoys high rates of post wage. Wage differentials could be as high as 20 times the average, depending on individuals' performance, such as calculated on a piece rate base. The compensation is basically biased in favor of salesmen, indicative of importance of market concerns. The size of payments to sales persons is closely tied to their sales volume per year. In general, annual incomes of salesmen can be as high as 20 times of a production worker's. In the past two years, company houses were awarded to outstanding salespersons, who only need to pay part of the flat costs bought by the company in markets. This marked a departure from the past provision of housing as welfare to a means of rewarding and retaining key employees.

Most flexible compensation component of the reward package in all the firms studied is the widespread use of bonus payments. Here, bonus payments are not only widely used as incentives to elicit employees' work efforts, but also closely linked to individuals' positions and job tasks on a flexible base. Most significantly, individuals' bonus payments are not fixed beforehand; rather, they vary substantially with employees' individual performance. Together, the total amount of individuals' bonus payments is contingent on the firm's profit revenues.

It should be noted that bonus payments constitute increasing part of the annual incomes of employees in today's China[25] (see SSB 1998: 158; Yao, 1997). Empirical evidence revealed from this study shows that individuals' bonus payments are monthly and/or annually paid, contingent on the firm's profitability. Moreover, the scale of bonus payments varies considerably among employees, with core workers getting higher bonuses than the peripheral on a monthly base, or with managerial staff receiving a lion's share bonuses on an annual base. Therefore, bonus payments are closely linked to the performance of both the individuals and the company.

Case study PhW-2: Flexible bonus payments

Besides regular wage rewards, there are monthly bonus payments applicable to all employees. The scale of bonus payments is linked to

[25] Bonus payments account for 25 per cent of the employee's wage payments on average in SOEs in 1997 (SSB, 1998:158)

profits that the company earned every month. Often, bonus payments are biased in favour of production workers and technicians, accounting for 20 per cent of their monthly earnings. In particular, the bonus payment made to salespersons is directly linked to their sales volume achieved on a year base subject to a quarterly appraisal. For instance, a salesperson who sold products of RMB 10 million yuan was awarded a company flat worthy of RMB 200, 000 yuan, plus a bonus of RMB 100, 000 yuan. In 1997, employees' annual incomes in the form of wage and bonus averaged RMB 9,000 yuan, almost double the local average. Income differentials can be as large as RMB 1500 yuan between production workers and non-production personnel on average.

Case study PhS-5: Bonus payments and the company's profitability
The aggregate amount of bonus payment is linked to the company's disposable profit revenues subject to the state compensation regulations. The disposable profits are further discomposed to each sub-section (i.e. functional departments) at a lower level of the organization. In this way, bonus payment varies with performance of each sub-division. In practice, the scale of individuals' bonus payments varies with individual employees' performance screened by his position in the job ladder, as well as his work responsibility. For a production worker, if performance can be metered individually, bonus payments are made in piece rate. In case there is teamwork, group performance is assessed and bonus payments divided among the group members based on their skill levels, and responsibility undertaken in the work team. For non-production workers, bonus payments are more or less linked to the employee's performance screened by his position in the department. Differentials in bonus payments are not significant among managerial and administrative staff.

One exception in the bonus payment is the case of TeleW-1, where the firm's high profit revenues are not immediately translated into employees' monthly bonus payments. Instead, only annual bonus payments are offered to individuals, and the scale of bonus payments is restricted to 5 per cent of employees' annual salaries. In other words, the 95 per cent of employees' salary incomes is paid accountably in terms of monthly salaries, subject to the government income taxation. Besides, there is a certain amount of fixed holiday allowances, proportionate to individuals' salaries. This distinctive reward system at TeleW-1 is claimed to follow the international reward practices. Essentially, it is modeled upon a typical Dutch compensation practice, as the company's initial foreign investor was from the Netherlands.

Case study TeleW-1: Toward formalized compensation practices?
Compensation for employees in the company is claimed in line with international standards. Rewarding systems take the form of post wage, plus allowance payments, with the post wage as a dominant part of compensation (95 per cent). As distinctive from both SOEs and other non-state firms, there is no payment in kind in the company. Instead, wage compensations for employees are made mainly in cash, and subject to the

state income taxes. This is why wage incomes in the company is over ten times higher than the local averages, while the actual incomes after taxes is not as high as nominal incomes on employees' wage bills.
Apart from monthly wage compensations, employees receive additional payments in the form of subsidies containing travel expenses, and holiday allowances. Bonus payments are made annually rather than monthly. As the state controlled joint venture, the company does not have stock option schemes available for employees. Overall, the total amount of subsidies is restricted below 5 per cent of individuals' total annual incomes.

In addition to bonus payments, employee share ownership schemes are widely adopted as means of complementary compensation for employees' commitment in all the investigated firms, with an exception of TeleW-1[26]. In TeleS-2, for instance, the use of employee share ownership schemes is management's attempts to strengthen employees' identification with, as well as their loyalty to the organization and the job.

Case study TeleS-2: Toward the skill-based majority employee share ownership
As a leading IT player in China, the company has designed very attractive stock option schemes that tie interests of individual employees to that of the company. Moreover, stock options seek to balance short-term interests of employees and the long-term goal of the company. As is the case in wage compensation, stock options are not indiscriminately applied to the employees on an identical base. Instead, the access to stock options depends upon one's job positions and responsibilities. In 1997, for instance, 30 per cent excellent employees received collective stock options of the company; 40 percent of key employees were individually granted stock options; while 10 to 20 per cent of ordinary employees and new entrants are selectively offered stock options based on their performance, and seniority.
Often, the company deliberately biases stock options in favour of key employees that form the core of the company's human resources. Egalitarianism in compensation is broke up, and employees' income differentials are encouraged and linked to their wage & bonus payments, as well as to stock options. All together, individuals' incomes are floating with their performance, skills, responsibilities (or positions), as well as profitability of the company.
As being a private telecom firm, the company's compensation practices can go beyond the local government income ceiling imposed on SOEs. Despite the full autonomy in compensation, top management adopts the so-called self-regulated rewarding mechanisms. That is: during the business upturn, the company ensures that the employees would be rewarded above

[26]The exception derives from TeleW-1 as being a foreigner involved joint venture with the state controlling the majority of its equities. From the government viewpoint, it is claimed that employee share ownership schemes would bring about a conflict with the initial equity joint venture contract.

the average incomes of industry, and locals; when the company confronts a business downturn, or persistent economic depression, an automatic wage reduction policy will apply to all.

In the six pharmaceutical firms studied, a striking distinction can be made between state firms and private firms in the design of employee share ownership schemes. While state firms (PhW-1, PhW-2, and PhW-3) simply sold part of the companies' shares to the existing employees once-and-for all (on a voluntary or involuntary base) during the corporatization, private firms strategically design stock options as a pay, as well as an incentive mechanism, to retain and motive certain key employees. In the former case, employee share ownership schemes (through the sale) serve as welfare distributive functions that have little impact on motivating employees for hard work, especially for later new comers. In the latter case, stock options are tailored to elicit high commitment of certain fractions of employees whose skills and expertise are of strategic importance to the company's success.

Case study PhW-1: Employee's share ownership schemes
Besides monthly wage payments, and year-end bonuses, incumbent employees held a certain proportion of the company shares encouragingly purchased at the time of corporatization in 1994. This employee-share-ownership scheme was not so attractive as bonus payments. Because employees are uncertain of the returns on their share investments, given the declining profitability of the company in recent years. In the view of a general manager interviewed, a symbolic presence of equally share-owning scheme among the employees serves as a welfare benefit distributive function. The persuasion of employees to buy their shares was seemingly voluntary but actually compulsorily. The general manager himself acknowledged that the sale of share to employees was against the will of employees. The employees might otherwise relinquish their rationed share quota concerning uncertain returns on their investments. The primary purpose of the employee shareholding scheme was to *1)* enhance the identity of the employees with their employing company and, *2)* to tie individual employees' interests to the company's performance.

Case study PhW-2: Seniority-based employees' share ownership scheme
Employee stock ownership schemes were made once-and- for all available to employees when the company was corporatised in 1993. That means only old employees on the payroll held a proportion of the company's shares. There were three packages of share options opened to employees at the time of corporatization on their wills: 1000 shares, 2000 shares, and 3000 shares. Employees took any one out of these packages had to pay a preferential price of share's value, and would expect to receive a dividend on shares. Newly recruited employees since then missed such opportunities.

Frequently, reward systems in private firms contain accountable components that can

easily be traced back either to individuals' skills, or positions, or both, rather than on seniority. In addition, the private firms studied intentionally tailor their stock options to retain the core employees or managerial staff whose skills and expertise constitute the key competence the organization (e.g. PhW-4, and PhS-6).

Case study PhW-4: Efficiency wage effects

The company adopts a wage point system that is not very different from the prevailed structural wage system in SOEs. In principle, individuals' wage payments rely on one's managerial position (only applicable to managerial staff), technical title (standing for a skill level), lengths of services (including both within the company and prior to the entry), and education attainment. Each of these four items carries certain points of weights assigned by the deliberately set rules. The total weight points of all the employees are added together and then linked to total profits of the company in each month. In this way the value of each point is calculated in cash, and the amount of wages for each employee is worked out. More points one has, the higher the wages will be received. However, the rate of each point is not fixed but ultimately contingent on the amount of profits made every month by the company. Accordingly, individuals' wage payments not only differ considerably from each other due to their different points of wage, but also vary with the fluctuation of the company's profitability over time. Therefore, there is no pre-fixed amount of wage payments for employees except for the fixed points of wage.

The wage point system enables individuals' wage incomes to closely link, and float with profits of the company over the time. It also allows individuals' wage scales to be differentiated among employees carrying with different points of merits. For instance, wage differentials can be as high as RMB 2000 to 3000 yuan per month between executives and managerial staff at different levels. For the production workers, piece rate is used as a means of compensation if their performance is measurable individually. For the mobile salesmen (made up of the majority of the employees), sales volume is the main determinant of one's income. Therefore, there is no unitary form of wage compensation practices. The most distinguished feature of this wage point system lies in its close linkage between individuals' efforts and rewards in a dynamic manner.

Apart from wage compensation, stock options are designed as another important form of rewarding for outstanding star employees, especially managerial staff, outperformed salespersons, distinguished technicians at each year-end. Here, stock options serve in essence as an effective incentive mechanism. In addition, stock options are also a means of retention of excellent employees in the company. With stocks accumulated to a certain amount, one can automatically acquire a permanent status in the company, in addition to enjoying dividends on the stocks. Permanent employees can be entitled to the company's arranged housing, a car, medical insurance, and pensions.

Wage incomes paid for each employee in the company averaged RMB 20,000 yuan in 1997, nearly three times the annual wage incomes earned

by a local state employee. High wage payments attract more applicants than required, which exerts a great pressure on the working employees in the company. Strict labour disciplines are implemented at the workplace that cover punctures in time for work and leave, absence of sick leave, daily behavior, good conducts in business, absenteeism, and etc. Employees' violation of labour disciplines will be subjected to heavy fines, even risking job losses.

Case study PhS-6: Performance related compensation

The company's wage compensation is mainly based on the employees' posts and skills. Other two rewarding components (namely bonus, and allowance payments) are also linked to one's post and skill in one way or another. The four components in wages are adjustable to profits of the company every half a year.

In principle, the wage scale of an individual employee depends on his employment position (one among the four categories of managerial, technical, administrative staff, and worker), professional title (standing for skill level). Performance-related bonus payments made to employees are linked to the company's profitability, and adjustable every half a year to the fulfillment of the set target. Each employee's bonus payment is thus tied to the profit fulfillment of his employing department and varies with his employment position and professional title. In the same way, post allowance payments are restricted to key employees who hold a managerial or technical position. Production workers and routine managerial employees are not entitled to post-related allowances.

The average gap in annual earnings between managerial personnel (including managerial, technical and administrative staff) and workers is around 2 to 3 times with the workers at a low end of the wage scale. In 1997, average annual wage income for an employee reached RMB 36,000 yuan in the company.

Apart from pecuniary payments in the form of wage and bonus, stock options are offered to incumbent employees with lengthy services and key positions in the company. Again, the core employees (consisting of managerial, technical, and administrative staff) are main beneficiaries of the stock options, while manual workers are not entitled to participate in stock option schemes. Apparently, managerial personnel (i.e. the core employees) are perceived much more valuable than production workers (i.e. the periphery). Another possible explanation is that the majority manual workers are not regular citizens of the city, so that they are easily subject to discrimination and exploitation.

Comparatively, reward systems in the state firms studied, regardless of their locations, contain complex and less accountable components, and have mixed compensation bases. Although some flexible compensation practices are increasingly adopted, most state firms investigated are still subjected to the state wage regulations (i.e. the *two lowers*[27]). In

[27] That is, the rate of total wage increase should be kept lower than the pace of local GDP

practice, persistent poor performance in most state firms, coupled with the over-manned employees, renders the compensation of employees relatively low in scale while very complex in components (e.g. PhW-2).

Case study PhW-2: Flexible compensation under the state guidance

The company has two reward systems under practice. One is designed for production workers and another for staff (including managerial and technical and administrative personnel). For the former, piece rate is applied to production workers, whose wages consists of basis living expenses (fixed at RMB 280 to 300 yuan) and a pay on the piece rate (floating). Service wages (i.e. seniority payment) and various subsidies are incorporated into basic living expenses, rather than set as a separate part of total wages, as the case in other companies. If workers work in a group, and metering individuals' performance is difficult, a group performance will be measured and compensated. In this way, the piece rate is determined mainly by the total amount of profits that the company has earned from sales revenues on a monthly base. If product orders decline, less working hours or fewer days will apply, so leading to reduced payments to workers. When faced with a slump in market demands, some workers are required to stay at home waiting for production tasks. They are called *Xiegong* (i.e. temporary free at home), and they only receive a little more than basic living expenses. In this way, they are distinguished from layoffs that were downsized and wait for reemployment in the company behind the *Xiegong*. Thus, in this way, individuals' compensations are not only linked to their performance but also associated with fluctuations of production.

A structural wage system applies to staff and is made up of two main components: minimum living expenses and post wage, multiplied by a coefficient (based on workload and responsibility). The minimum living expenses for the staff are fixed at RMB 180 yuan (i.e. equivalent to the local minimum living line set by the local government). This part of fix payment has nothing to do with the staff's individual attributes, but is set at lower than the basic living expenses received by laid off workers. The purpose is to encourage overstaffed non-production personnel leaving to work in the first line -- production plants. The second part, i.e. post wages, for staff is determined by one's status on the management hierarchy (for managerial and administrative staff), or by one's technical titles (for technical personnel). A technical employee only after being appointed by the company can be entitled to receiving post wage payments.

Apparently, two parallel reward systems in PhW-2 do not pose any problems of

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growth rate, and the pace of individuals' wage increase should be lower than the rate of labour productivity growth in the company. There is an elasticity of wage increase relative to labour productivity: a rise in the company's profits by one point of percentage over the previous year can lead to a rise of 0.5 point percentage in the total wage quota in the coming year, and vice verse (see chapter 2).

inconsistency. Rather, they are tailored to reward employees for their performance and contribution that differ in terms of skills and functions, which is liked to individuals' effort measurability and productivity.

In short, all the firms studied adopt reward systems that incorporate flexible payment components ranging from variable wages to various incentive schemes. The prevailing reward system, as observed in most firms studied, is made up basic wage (traditional standard wage), functional wage (linkage to positions or skills) and variable wage (linkage to performance). In particular, both piece rate and time rate are widely used among production workers, whose performance can be easily measured individually at plants. Attractive stock options and employee ownership schemes, where available, are, selectively applicable to skilled employees or key staff in order to enhance their incentives for a long-term stay with firms. Eventually, flexible reward systems and compensation practices come in tune with flexible working practices as observed at the workplace.

However, significant differences in wage scales and compensation practices still exist between the state firms and non-state firms included in the study. There are two reasons for the observed difference. First, the non-state firms studied are able to pay their employees at higher wage rates that are several times the wage levels in the state firms. In economics, wages have three functions of allocation, distribution, and incentives (Lazear, 1998). Of the aforementioned three functions, the incentive effect of wages is most powerful in the sense that increased wages and bonuses can motivate employees to work hard, and to stay with the company. Higher wage rates prevailing in the non-state firms studied can help management to attract and retain most talented personnel into organizations whereby increasing functional flexibility of employees.

Second, the non-state firms studied can formulate their own pay scales and flexible forms of compensation practices free of the state intervention, whereas the most state firms studied are still subject to the state wage guideline that set a limit on management to flexibly reward employees. Despite the setbacks mentioned above, some progress is observed in the state firms studied. For instance, management in state firms has acquired increasing discretion in rewarding employees for their skills and performance. Compensation on seniority, that is absent in the non-state firms studied, becomes less and less important in some state firms. In most state firms investigated, wage incomes are no longer uniform and egalitarian among employees within the firm and across firms. Instead, the scale of compensation and the composition vary sharply with skills and performance of individual employees.

Despite relatively low compensation capacity in state firms, positive changes in reward practices as observed in the state firms studied indicate departure from the past uniform compensation regulated by the state, toward flexible compensation determined by the firm's management. However, Inconsistency of the HR system with respect to wage policies most likely arise in state firms where some compensation practices (e.g. skill-based wages) are transformed to market practices while others (e.g. post wages, and service wages) are still distorted to meet the state wage guideline. As a result, internal consistency of the firm's HR system is hardly to maintain when reward practices contradict with other HR practices as assumed in labour contracts.

6.2.4 Training and development

To address training and development, three questions can always be asked: Why do firms train employees? How is it organized? And who will bear the cost of training? From the human capital theory perspective, firms train employees if the net benefits accrued exceeds the cost of the training (Baron and Kreps, 1999).

Training can be organized on-site or off-site, and delivered internally (in-house) or by an external vendor (out-house). It can be tailored to individuals or groups, with the focus on particular job competencies or general skills. Besides skill-enhancing impacts, training has symbolic, motivational, and interpersonal effects.

However, training is costly, and the return on training is uncertain. The firm's investment in the employee's human capital is most likely if such an employee would stay with the firm for a length of time, and if the skills acquired through the training complement other skills the employee already may have.

As noted in chapter 2, firms in China used to heavily rely on external state education institutions and vocational schools for the supply of all kinds of skilled labour (Walder, 1986; Warner, 1987). Although some large state firms ran their own technical schools, participants to those schools were mainly offspring of the incumbent workers, not current employees themselves. The costs of schooling and teaching were born by the firm (Steinfeld, 1998).

Beginning in the 1990s, most state firm-ran technical schools were either closed down in the face of hardening budget constraints, or converted to training schools financed internally by firms. External reliance on the state education institutions for graduates has become a main source for the supply of skilled labour, but such reliance is becoming less reliable, and lacks any warranty. In the meantime, the state started to promote students' self-financing university education in the 1990s. As a result, university graduates obtained freedom to choose employment opportunities on labour markets, instead of by the state assignment (Hong and Warner, 1998). State firms, when facing a shortage of skilled personnel, need to compete with private firms, for qualified young graduates on markets. If they could not offer (in most case, they cannot), employment packages as attractive as in private firms, management has to find alternatives, either by organizing training internally, or by external institutions (e.g. universities).

The empirical evidences revealed from this study suggest some positive changes in *forms*, *contents*, and *frequency* of training, as compared to the past. Table 6. 4 sums up the empirical findings on training that were collected from the eight investigated firms included in the study.

First, most of the investigated firms have very preliminary training and development programs. Training, though being regarded as important, is not so urgent as other personnel issues such as recruitment, labour contracts, and wages from the management perspective. Training is often narrowly defined, lack of strategic focus. Most of the training programs are geared mainly to new hires upon their entry. This roughly conforms

findings revealed from other empirical studies (Yu and Bjorkman, 1997; Verburg, 1996; Ding et al, 1997).

Table 6.4. Training and development in the eight investigated companies, 1997

	PhW-1 (SOE)	PhW-2 (SOE)	PhW-3 (SOE)	PhW-4 (Priv*.)	PhS-5 (SOE*)	PhS-6 (Priv*)	TeleW-1 (Jovt*)	TeleS-2 (Priv.)
I. Forms								
• In-house (on-the-job)	√	√	√	√	×	×	√	√
• Out-house (off-the-job)	+	+	+	+	+	+	+	+
II. Contents								
• Procedural (rules)	√	√	√	√	√	√	√	√
• Substantive (job skills)	+	+	+	+	+	+	+	+
III. Frequency								
• Regular	×	×	×	×	×	×	×	×
• Irregular	√	√	√	√	√	√	√	√

Note: "√"= yes (existed) "+" = in parts "×" = no (non-existence) "*" = the presence of foreign investors.

Second, training activities are largely organized in house, rather than out-house. In-house training programs are basically designed for new employees upon their entry. Contents of such training are narrowly defined and fragmented. Most of the in-house training programs are actually on-the-job training, focusing on procedural rules such as labour discipline, work safety, and corporate culture. Job skills are not sufficiently stressed in the training. Out-house training, if available, is mainly confined to managerial or technical employees that are conceived as the core in the organization, focusing on general professional training or personal human and intellectual development.

Moreover, both in-house training and out-house training are short-term, and organized on an irregular base. In particular, the traditional apprenticeship system, under which firm-specific skills are acquired mainly through learning-by-doing, is widely reported in all the studied pharmaceutical firms, but it is absent in the two telecom firms. Significantly, self-learning is encouraged, and the cost of learning is conditionally shared by the individuals involved and the company.

Case study PhW-1: Limited training programs

The company offers new recruits short-term training upon their entry. Job-related training is very rare for other ordinary employees. The traditional apprenticeship system remains as a main means of training new employees, through learning by doing, especially for newly recruited production workers.

Out-house training is occasionally organized by government supervising agencies, featuring a tour or a study visit. Such a tour or study visit in the

name of training is mainly restricted to managerial staff; although technical staff is sometimes invited as well. Besides, individuals' self-learning is encouraged and has becomes an important means of skill acquisition, complementary to training. Self-learning attracts a number of young employees through five informal universities (namely, TV.university, correspondence university, night university, vocational university, self-learning university) operating during their spare time. The company encourages such a self-learning and pays half of the tuition fees when the employee receives a certificate or diploma if such a learning is relevant to his work undertaken. Younger employees show high enthusiasm for such self-learning. Because once they reach a degree of college education through self-learning, they are supposed to have more chances in career improvement, like, promotion, wage raise, and professional title. More importantly, their employability will be enhanced by acquiring new skills and knowledge through such a self-learning.

Most strikingly, the firm-run technical school is gradually converted into an independent training school, with a focus on training employees for firm-specific skill, rather than on general education of the employees' children (see chapter 2). In PhW-1, for instance, the company-run technical education school was transformed into a training school for its employees in 1995. Senior technicians are now involved in the technical training of new recruits, with a focus on technical aspects of operating, and quality control. This training is combined with another aspect of adaptive education, with an emphasis placed mainly on work procedures and labour disciplines. Both aspects of training are roughly job-related, and take place irregularly, half day per week, for new recruits.

Yet, one striking difference in training commitment exits between the state firms and private firms situated in the same labour market. In PhW-2, a state firm situated in Wuhan, for instance, management tends to train a few of promising employees externally on contract, instead of making within the organization. In PhW-4 (a private firm situated in the same market as PhW-2), extensive training is organized internally, focusing on procedural rules and the corporate culture, whereas limited external training opportunities are confined to few managerial employees on a very selective base.

Case study PhW-2: Training and organizational core competence

In this corporatized state firm, top management recognises the importance of training in upgrading skills of key employees to success of the business on competitive product markets. Every year 10-12 per cent of sales revenues is set aside as training investment funds. In addition, the company sees training opportunities as an effective means of retaining key technical personnel, which is accompanied by promotion from within after training. This can be partly explained why the turnover of technical personnel is low as compared with other employee groups.

External training is organized in universities for promising employees in possession of a college diploma at least. Such training opportunities are offered to key researchers and core technicians. Applicants for the training are mainly selected from the R & D and the engineering departments.

Often, newly recruited university graduates have a high likelihood of being selected for external training if they have worked there for three years and have a good performance record. Selection is conducted by relevant departments in close co-operation with the personnel department, and finally decided by the general manager. Trainees are sent to universities for a graduate study in medical sciences, their tuition fees, as well as living expenses, are borne by the company. In exchange, they guarantee to work in the company for a certain period of time (five years), which is specified and written in a contract. In 1994, for example, the company sent two employees for a graduate study. One was promoted as a director of the Research Institute when returned after finishing the study. In 1997, three new recruits with university diploma were sent to universities for a full time graduate study. The company bears all tuition fees and pays them salaries every month during their study period.

Comparatively, in-house training is not as significant as external training. On-the-job training is organised in the company, focusing on procedure rules of work, as well as job substance. One important form of the on-the-job training is organised in collaboration with a local university by offering college courses tailored to young skilled employees (two-year programme) in the company. In 1995, for instance, 45 employees were selected to attend such college courses on weekend. Participating employees did not need to pay tuition fees that were born entirely by the company.

Ordinary workers are encouraged for a self-study by attending Vocational Universities, or Evening Universities during their spare time. If they pass an exam of a single subject relevant to their job contents, they will be awarded a certain amount of cash ranging from RMB 100 to 500 yuan. By the time they succeed in receiving a diploma, they will be promoted to a higher level of skilled workers, and high pays ensue.

Case study PhW-4: Training and corporate identity

The company has its own training institution, called *Confucian Merchant College,* the name mirroring the scholar background of the founder who used to be a university professor. The HRM department is responsible for organizing and implementing training programs, sometimes in cooperation with guest instructors invited from local universities. The college has its own textbooks written by the company senior staff from various functional departments in the light of its own business experiences. The college has extended its training systems to the company's subsidiaries that are geographically located in different provinces (i.e. market segments) across the country. The period of training in the college headquarters and its subsidiaries varies from one week to three months and one year in length, depending on the target employees at different levels of the organization. The training standard can be classified into three grades: i.e. high level (i.e. management training), middle level (functional training), and low level (i.e. new employee training).

Training designed for new employees is compulsory immediately after their entry. Each new employee is obligated to attend training (lasting 3 to

7 days) for a job position that will be assigned. The contents of training contain procedural rules and work substance, of which the corporate culture[28], corporate missions, labour disciplines, and behaviour conduct are stressed. With such training, new employees are expected to integrate into the organization through socializing or inculcating individuals of the corporate culture and missions.

Substantive training contains a variety of business routines including legal regulations, marketing, sales promotion, advertising, communication, production, knowledge of product attributes, and etc. Of which marketing and sales skills are at the core of substantive training. Such training starts with general knowledge of business process in the company, which is followed by the specific on-the-job training during the three-month period of probation. Every new employee is required to pass the training examination in the end of the probation. Only the qualified recruits after passing the exam will be allowed to take a formal job on a contract of one or two year base.

In addition, a short term of adaptive training that is held at the college all the year around is designed to those employees who are not adaptable to their performed tasks due to their low skills or poor performance over successive three months. Participants are those who were temporarily laid off from different departments and sunk into the college for a short-term adaptive training before they can be accept a new assignment. Such training only lasts for 10 days during which participants have to learn something new that would be needed by other departments in the organization. In case there is no employment opportunities available to them at the end of 10 days' training, they will be given extra five days more for training and waiting for a job assignment inside. Then after, employees will be encouraged to leave.

In fact, the so-called adaptive training at the college in PhW-4 is more punitive than skill acquiring. Not only because such training means a face loss but also implies a bleak prospect for a continuing stay with the company. Moreover, trainees falling in this adaptive training will suffer a loss in incomes by half of their full job wages based on wage points, without bonus payments at all. The majority of trainees voluntarily left the

[28]Twelve sets of the corporate cultures are claimed as reflective of the company's mission: 1) Conducting businesses, just as conducted as human being. 2) Whatever white or black, a good cat is one that captures mouse. 3) Wherever come, show yourself up on markets. 4) The most difficulty in gaining the greatest esteem in the world is honesty that is valued most by the company. 5) Do you best and bring your talents into a full play. 6) Compare your demerits by others' merits rather than contrast your virtues to others' defects. 7) Broadmindedness makes one unselfish, and selfishness in turn brings one with more broadmindedness. 8) The shrewd is often misled by his trick, whereas a mastermind succeeds in every step. 9) There is always something implicit in words of others. 10) Being a man of lofty aspiration, as well as being a man of action. 11) To be competent, to be courageous, to be able to fulfill one's duty and do it well, with comma forever instead of full stop. 12) We are real masters of the company in which our dreams can come true.

company when they are sent to the college. Only the minority of the trainees waits for a job reallocation if the internal structural adjustment results in good performance.

Apart from the in-house training programs at the college organized by the HRM department, external training programs are designed for managerial and technical staff to attend at other institutions. For instance, the company selects a group of middle managers from different departments for a short-term MBA training offered by local universities. Tuition fees are fully born by the company, and the participants are obliged to stay with the company for a certain period of time after completion of the training. Such terms of training is not specified by a contract but by a special incentive scheme such as stock options, and bonus payments. External technical training does not take place as often as managerial training. In most cases, the company tends to recruit new technical employees on markets rather than to launch training of the existing employees.

Basically, the company tends to '*buy'* qualified personnel on markets rather than to '*make'* it within the house when the relative transaction cost of buying is cheaper than making (Williamson, 1981). Despite the existence of internal training programs in the private firm PhW-4, the emphasis of internal training is placed on corporate culture and missions, aiming at fostering employees' identity with the company. Moreover, the so-called adaptive training serves an internal labour pool on which excess labour will be internally reallocated, and risks of laying-off are spread among employees. Frequently, there is mounting pressure on trainees to leave voluntarily once they are laid off from jobs to take adaptive training at the college.

The difference in training priority between the two firms with different ownership forms (i.e. PhW-4 and PhW-2) situated in the same city of Wuhan arises from their different labour market positions and influences. The private firm (i.e. PhW-4), with its higher wage rates attracting well-educated workers from local labour markets, only needs to give its employees procedural training, rather than substantive training for job-related skills. Whereas the state firm (PhW-2) has to put a great emphasis on technical skills of trainees organized both inside and outside the organization. In other words, when a state company (i.e. PhW-2) cannot offer higher wages (subject to the state wage guidance policy) to attract qualified new entrants from labour markets, the only way to get around skill constraints is to organize training internally or externally by focusing on firm-specific-skill acquisition. To some extent, the resulting differences in labour market capacities between the two firms can be attributed to their ownership that leads to different training formats.

Apparently, behind management's commitment to employees training are the firm's external labour market conditions, as well as management's cost-effectiveness consideration. For instance, two pharmaceutical firms (i.e.PhS-5 and PhS-6) located in the SSEZ are reluctant to involve their employees in training. Instead, management in the both firms relies overwhelmingly on external markets for various levels of skilled labour as needed. This is possible because relative high wage levels in Shenzhen (7-10 times higher than the inland average) enable local firms to recruit desired personnel easily on markets. As a result, investment in training of employees for skill acquisition is the firm's last resort after a market searching in SSEZ, as compared to firms in Wuhan.

Case study PhS-5: Reliance on markets for skilled labour

No employment training programs was organized in the company, and the company is not going to offer training in the future. All kinds of employees as required can be easily recruited from labour markets, or the General Talents Exchange. From the management viewpoint, buying qualified personnel on markets is more effective and efficient than making one inside the company. This strategy of buying is partly associated with the routine technologies employed in the company. In other words, there is no firm-specific skill requirement for employees to take jobs in the company. Reliance on loose labour markets especially enables management to easily adjust labour inputs to demands without incurring costs. In addition, both the company and the employees are not interested in maintaining a longer employment relation. This is reflected in a high labour turnover (60-70 per cent) in the organization.

On the other hand, no internal training program available for employees means that a strict recruitment and selection of employees is imposed on ports of entry. The company stresses educational attainments of job applicants upon entry. The personnel department is engaged in recruitment and selection in more selective ways, and in cooperation with the relevant functional departments. Sometimes, a written test applies. After the entry, new recruits have to pass a probation that lasts for three months. During the probation period, new employees will put under the apprenticeship system, under which they are expected to acquire job-related skills through learning by doing.

Employees' self-learning during their spare times is encouraged by the company. Work pressures, as well as the constant threat of being replaced by other qualified applicants, force employees to learn new skills in other ways around if the company does not provide then with any form of training.

Yet, there are some management training programs for senior managers organized by the local government agencies under their administration. The training contents are not always necessarily related to business operations. Often, non-business contents such as government reform policies are included in the management training.

Case study PhS-6: Externalized training activities

In-house training is not available, except for a few days' training that is offered to new recruits during the probation period of three months. The contents of training focus on procedural rules rather than on substance of jobs. An apprenticeship is then followed in the plants through learning-by-doing in which a firm-specific skill is expected to acquire.

Whereas out-house training is open only to managerial and technical personnel who are perceived as the core employees, with a prospect for a further development in the company. External training programs are either externally organized by universities or by industrial associations with MBA as a main content. The company selects key managerial employees and pays the tuition fees for their training. If trainees leave the company

> immediately after the training, they have to compensate the company for a loss of training investment. To date, the company sent 20 young employees for MBA training in a Northern Engineering University. The company promises to pay their tuition fees and living costs only after they graduate and come back for a service.

Higher wage rate really matters especially when it influences the firm's training decision between 'making" and 'buying' if the required skills are available on markets. In two telecom firms investigated, exceptional higher wage rates endow management with strong market power in attracting talented people into their organizations. This labour market power, in turn, saves the companies enormous investments in off-the-job training. Moreover, the flow of highly educated labour allows the company to easily launch any on-the-job training programs more effectively. In TeleW-1, for example, attractive compensation offers often induce ten times qualified candidates competing for one job vacancy. Thus, very limited internal training programs are designed for new entrants to focus on procedures, rather than on job content. Occasionally, out-house management development training is organized abroad for key managerial staff in these high rewarding companies.

> **Case study TeleW-1: Limited training programs are designed to meet short-term needs**
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> Since wage offers in the company is over ten times higher than the local average, many candidates are waiting outside for an entry into the company. Frequently, one job vacancy can have 500 applicants competing for filling in. Despite a plenty supply of candidates, the company pursues a very selective recruitment policy for any job vacancies.
>
> Limited internal training programs are organized in the company, and coordinated by the HRM department. These training programs usually take place at the time of new entry, or during the three-month period of probation after the entry. Such training is designed for new entrants, with the emphasis mainly on procedure rules, instead of on job contents. Every newly recruited employee must pass an exam for a training certificate before being assigned to a job position.
>
> On-the-job training is followed immediately after the initial training for new entrants. This type of training is organized in the company mainly for new production workers after they are staffed in designated positions. The main manner of such training is via learning-by-doing under an apprenticeship system. Senior skilled employees are requested to act as a master in supervising new recruits for a period of time. New recruits are expected to acquire firm specific skills in this way.
>
> Occasionally, training programs for multi-skills outside the company are provided mainly for managerial and technical staff. Key managerial, or technical employees are dispatched to the parent company in the Netherlands, or its subsidies in US., or in Singapore for a short period of training. Technical, marketing, and managerial know-how is a focus of the training contents. The majority of senior managers and engineers have gained at least one chance for such training abroad. The company bears all

the costs of training. Every year, the total training investment amounts to RMB 190,000 yuan, although not high in proportion to the annual turnover of sales (RMB 800 million yuna), the majority of the investment is spent on training abroad.

The same trend is observed in TeleS-2 situated in Shenzhen as well. Due to the relatively high educational level maintained for new entry, most of the training activities in the TeleS-2 are informal, spontaneously organized by employees themselves in the form of seminar, or workshops during their spare time or at lunch. Top management strongly advocates individuals' self-learning for new skills, in parallel with collective learning in team. In order to motivate individuals for self-learning, for instance, the company set aside a study fund of 30 million RMB in 1997 that can be applied to cover related book purchase expenses. Accordingly, each participant is required to spare at least 7 per cent of his working time on learning and giving a presentation to group seminars. Beside self-learning, compulsory internal training programs are organized in the company, and targeted at new entrants. Much of such internal training efforts are devoted to instilling the corporate culture, or fostering employees' identity with the company. In addition, external experts or consultants are occasionally invited into the company to offer management-tailored training programs (such as TQM, and MBA courses) for the core employees.

Case study TeleS-2: Towards a learning organization

The company is widely regarded as a knowledge intensive company due to its highly educated workforce employed by the Chinese standard. Top management particularly recognizes that human resources are most valuable resources in the organization worth of investment. It claims that no other resources can be more important than human resources that continue adding value to the organization. In order for human resources to be fully utilized in the organization, necessary internal training should be conducted for new entrants. It is believed that such training can not only socialize individual employees into the organization by accepting corporate culture and core values, but also motivate employees for hard working.

Newly recruited employees are required to attend training upon entry, or during the probation of three months. The training is compulsory for all new entrants, with a focus generally on the corporate culture, procedural rules and labour discipline. Besides training of new entrants, on-the-job training is mainly conducted by the functional department, and financed by the company. It is enacted that the department manager is obliged to organize at least a training opportunity to his subordinates per year; otherwise, he will receive a discredit record in the management performance appraisal. Such on-the-job training varies considerably with functional departments. Some takes the form of seminars or workshop, while others are in the form of class lecturing. The contents of seminars, or class lecturing, are usually related to employees' job-specific skills, or technical problems confronted in the functional department.

Sometimes external guest lecturers are invited to give key employees specific training, which varies in length of one week, or a few hours, depending upon the contents of the training. Managerial training programs

> are occasionally organized to managers (senior and middle) in the company by inviting distinguished experts from top universities or multinationals.
> Apart from the above training organized by the company, employees' self-learning is particularly advocated. The company cherishes learning in upgrading employees' skills (both the technical and non-technical). For this purpose, the company promises to cover some costs of the self-learning materials, such as books. The general manager calls for employees to spare weekend time on reading and skills enhancement, not merely on relaxing. He advocates a unique '*culture of eating'* instead of simply 'eating' in the company, in the hope that informal but meaningful communications among employees and between supervisors and subordinates are sparking out during lunchtime or dinner.
> Employees are keen to learn new skills via self-learning. Most of them are committed to their jobs not only because of higher wage rates. They show high commitment to the company because they value good working atmosphere, lots of training chances, and ample promotion opportunities. The content of organized training is not merely confined to technical fields, though important for the company. In most cases, corporate culture, marketing skills are included in training organized by the company. To a great extent, technical skills or job-specific skills rely first on selective recruitment at port of entry, and then on individuals' self-learning after the entry. In-house training is organized to integrate individual employees into the organization by instilling them of shared common corporate values and missions.

Obviously, the above case study clearly shows that external labour market conditions strongly influence management's commitment to training of employees in the firm. When required skills are not available on local markets, management has to find out a solution of *make* within the firm through in-house training or contracting out to specialists (Booth and Snower, 1996). This in turn will shape the firm's training policies and practices (i.e. *buying on markets or making within the firm*) (Bulteer et al, 1995).

As empirical findings shown above, relatively loose labour market conditions in Shenzhen enables local firms to rely on markets for the supply of skilled labour, while in-house training is left as the last resort to *making* required skills within the organization. In contrast, companies located in Wuhan have to formulate internal vis-à-vis external training programs, with the aim of upgrading employees' skills that are not always available from local markets due to lower wage rates (see the preceding section on wages). Although the firm's training policy may not directly be traced back to management efforts to increase functional flexibility of labour, training priority and the relevant choice made indeed point to managerial efforts to attract and retain skilled employees in the organization. To some extent, relatively high labour turnover in all the firms studied in Shenzhen undermines management' commitment to in-house training.

Nevertheless, empirical findings on training from this research reveal that employment-related training is limited in all the firms studied. The content of training and the format

are primitive in the sense that most available training programs organized in house lack strategic focuses on firm-specific skills. And management's commitment to training is subject to the firm's external labour market conditions and cost-benefit considerations. Often, management regards training as liabilities (or costs) that should be born by workers, instead of the company.

Indeed, in-house training is irregularly organized for new recruits in most firms studied. But the content of the in-house training is narrowly defined to procedural rules, without a direct linkage to the development of firm-specific skills. Apprentices are sometimes employed to delivery on-the-job training to new recruits in their probationary period of employment. General training institutions (mainly local universities) are occasionally sought to provide outstanding training programs to senior employees in state firms (e.g. PhW-2), but whose spillover effects on other employees are extremely limited. Some companies that are reluctant to train their employees have to rely on the external labour market, and hence find itself in a position to regard labour as less more than a cost (i.e. PhS-5, and PhS-6). Hence, the presumed functional flexibility through multi-skill training programs is not observed, or fully realized.

Hence, it cannot be claim that management has stressed training adequately and strategically in all studied firm. In most cases, training activities are superficial, or lacking substantially work related contents. As a result, training that can be used as an effective management tool for promoting employees' incentives and commitment is not so evident in this empirical study. Besides, there is no clear correlate between skill-enhanced training programs and management's effort to increase labour flexibility. In particular, relatively high labour turnover among production workers, coupled with the constant hiring and firing (numerical flexibility), is both the reason for, as well as the result of, less training commitment of the firm to the workforce. Here, the relative transaction cost of the two training alternatives of '*buying'* and '*making'* indeed works to influence management commitments to training investment. Moreover, firms involved in training activities tend to protest its investment by offering long-term employment contract (PhW-4). Obviously, firms that invest in employees training benefits most when this activity is complementary to other HR policies, most notably policies that ensure appropriate screening of employees and that prolong employment and reduce voluntary turnover.

6.2.5 Welfare benefits and coverage

In Western economies, employment-related fringe benefits are increasingly integrated either in part or in full into the firm's compensation package[29]. Often, the company's employment welfare benefit policy extends to include intrinsic or psychic compensation, to magnify the corporate culture, and to enhance employees' identity with the organization (Baron and Kreps, 1999). However, the scope of employment-related welfare benefits is

[29] For instance, top-level executives are often compensated with equity or options to purchase equity; Managers and professionals are given perquisites, e.g. a company car; Ordinary workers are usually compensated with such benefits as contributions to health care, personal insurance, and pensions (see OECD, 1998)

subject to the regulation of industrial regimes, social policies, and legal systems (OECD, 1998).

In China, comprehensive social welfare coverage in SOEs used to be praised as one of the state socialist advantages over the capitalist economies. This has become a subject of criticism since market-oriented labour reforms started in 1985. The main critical point is that egalitarian welfare benefits had contributed to over-employment (i.e. overstaffing), as well as inefficiency in most SOEs (Warner 1987, 1995; Child 1994; see chapter 2). Since a wide range of the welfare benefits to each state worker was primarily employment-based, and varied sharply with different individual enterprises, some state firms with generous welfare provisions had eventually developed cemented-employment relationships that discourage labour mobility. Obviously, the comprehensive welfare coverage was extremely harmful to efficient labour allocation. It not only eroded much of the state revenues, but also contributed to poor performance of workers, and state firms. In particular, the company-based welfare provision resulted in employment rigidities that poses enormous difficulties for management to adjust labour to market changes after economic reforms.

As stated in chapter 2, the necessity for reforming old social welfare systems in the state sector came to the fore in the mid-1990s as most overmanned SOEs turned out in the red. The direction for the reform is to "establish social insurance systems and funds so that workers can obtain help and compensation when they are old, ill, injured at work, unemployed or giving birth" (Clause 70 in 1994 Labour Law). Following this new social policy guidance, some municipal governments started an experiment with social insurance reforms by pooling insurance funds from enterprises under their jurisdictions at local levels from 1996 (see Beijing Review, 1998; World Bank 1997). The purpose of this social policy change is aimed at: 1) separating employees from their employing organizations, and 2) relieving overburdens of SOEs' social obligations for their employees (see Table 6.5).

Table 6.5. Major changes in social benefits and coverage

	Pre-1994	**Post-1994**
Housing	Welfare distribution on seniority	Rewards for performance
Medical care	Free for all the state employees	Paid out of individuals' pocket
Pensions	Enterprise-based payments	Employment-based social pooling
Unemployment	Enterprise responsible	Local government responsible

The newly proposed social insurance programs under experiment includes five items: 1) pensions, 2) medial insurance against ill or injured at work, 3) safety insurance against the disabled at work or leaving contracted occupational disease, 4) unemployed insurance, and 5) insurance for female giving birth. The Labour Law states, "the social insurance fund shall decide its source of income fund according to the insurance categories and as planned as a whole by society. Employing units and their workers must take part in the social insurance scheme and pay the insurance premiums according o the law" (Clause 72).

Empirical evidence documented in this study reveals that all the state firms studied are cutting off welfare benefits to employees, or have externalized part of the welfare facilities to outside agencies (e.g. PhW-1). In particular, emergence of new social insurance schemes intends to separate employees' pension premiums, and unemployed insurance[30] from the employing companies. As a result, the past prevailed company provision of free medical cares and housing are replaced by cash payments in the forms of subsidies based on employees' services and job positions. Even if some state firms maintain part of their employees' medical cares and housing, it takes the form of cash compensation that is incorporated into employees' monthly wage payments (in the cases of PhW-1, PhW-2 and PhW-3). Obviously, as welfare benefits are stripped off, state firms are losing all credits or attractions to their employees.

Case study PhW-1: Changed rationale for social benefit provision

The company stopped housing distribution as welfare in 1996. New employees will not be provided with company houses any more. Instead, the company houses are used to reward outperformed employees, as a kind of incentive or a means of retention. The elderly employees, who occupy the company's apartments on a seniority base, are required to buy out their living apartments at a subsidized price. The subsidized price varies with length of employees' service in the company. Moreover, from 1994 onwards (driven by the government housing reforms), all state employees (old and new), had to pay 5 per cent of their monthly wages to the external mutual-housing fund agency managing a personal account of the housing funds. The accumulated amount of housing fund recorded on the personal account can be used as a mortgage for a loan in case the employee plans to buy an apartment in the future.

Free medical services are no longer offered to employees as welfare benefits. Instead, every employee received medical expense subsidies that were incorporated into their wage payments in 1994. The size of subsidies varies with skill levels of workers or professional titles of the staff.

In addition, other social welfare facilities have been or going to be externalized for cost-savings. For instance, a company run technical school (mainly for employees' children) was transformed into an independent training school providing training service to the company at a quasi-market price. Other welfare facilities such as employees' hospital, canteen, and kindergarten are planned to be externalized, or contracted out, to be responsible for their own accountability in next two years.

Case study PhW-3: Marketizing social benefits

Beginning in 1994, the company cut off a scope of social benefits to employees, ranging from housing, free medical care, to canteen, kindergarten. The employees' canteen and kindergarten were externalized

[30] According to the state regulations, employees' pension premiums and unemployment insurance must be compulsorily paid to specialized external pension agencies, by both the company and the employees, with the former bearing 17 per cent of the total wage bill and the employees paying 3 per cent of their monthly wages (HLB, 1997b).

as relatively independent entities, with services provided to both the company employees and the outsiders at a quasi-market price.
The company still maintains a clinic, providing medical services to employees at a cost price. Certain amount of medical subsidies is offered and incorporated into individual employees' wages. The amount of such subsidies varies with employees' service years in the company. In addition, hospital remedy expenses are no longer entirely covered by the company, for which employees have to bear a proportional part. The company stopped the housing provision to new recruited employees, who only receive a sum of housing subsidies. Yet, occasionally, housing provision is intentionally used as a means of retention of key employees, or as a kind of rewarding for performance. For those old employees living in company houses, they will have to buy them out at a company subsidy price.

In contrast, employment-related welfare benefits are moderately provided to part of the employees in the newly created firms (e.g. PhS-5, PhW-4, and PhS-6), for the purpose of incentive. Behind the moderate provision of welfare benefits in the newly created firms is management's cost effective consideration. In the two private firms studied (i.e.PhW-4 and PhS-6), for instance, management tends to offer higher wage payments to individual employees, instead a wide range social benefit provision to all the employees. However, all the private firms studied indeed provide their employees with some general social benefits that are strictly confined to work-related services such as employees' canteens.

Obviously, a convergent trend has emerged between the state and non-state firms included in the study in the scope of social welfare provision. The past wide range of welfare distribution in state firms was cut off, and the remaining is now transformed as a means of rewarding employees for their performance, or as incentives to elicit their long-term commitment. And such social policy shift in state firms came in time as the government called for the establishment social insurance systems at local levels outside companies prior to 1998 (People's Daily, 1998).

In contrast to the state firms studied, three private firms (e.g. TeleW-1, TeleS-2, and PhW-4) included in the study provide comprehensive social insurance packages for their employees as required by the Labour Law. Moreover, more attractive social insurance packages are formulated in these three private firms that signal as a sign of management caring for employees. The ability of the private firms to afford comprehensive social insurances for their employees in turn enable management to attract and retain key employees in the organization. Eventually, generous social insurance packages, when coupled with higher salary rates, render the loss of job in the private firms very costly to employees, whereby deterring unwanted labour turnover from the core.

Case study TeleW-1: Employees' welfare benefits beyond SOEs
The company has narrowed the scope of social benefits to employees since the set up. Fringe benefits prevailed in SOEs are moneytized in cash and incorporated into wage payments tied to the performance of employees in the company. This is the reason why wage rates appear ten times higher in the company than in other companies. In order to elicit sufficient

commitment of employees, the company offers comprehensive insurance packages to every employee covering their pension, medical care, unemployment as required by the government labour policy. Besides, the company provides an additional pension program to employees for their retirement lives. The company remains obliged to pay a similar proportion of a housing fund to employees who are required by the government policy to contribute 5 per cent of their salaries. All the housing funds are owned by employees and registered under their personal accounts for a housing purchase. In addition, each employee is entitled to the company provided housing loans at a preferential interest rate whenever he/she needs to buy a flat. As the interviewed managers stated, "we want offer our employees all the social benefits of SOEs in the changed face."

The company has a non-profit canteen open to employees for lunch, or dinner on night shift. Employees need to pay for their food at a cost price. The canteen is also open to host company's guests and clients when they visit the company on business. The other benefits available for employees are holiday subsidies or allowances (e.g. on the national day, and spring festival). Besides, the company runs employees' buses to transport them from home to the workplace every workday. This is so because the company is located on the outskirts of Wuhan, inaccessible to public buses. But, there are no kindergarten, employee hospital, and other welfare facilities in the company.

Case study TeleS-2: Converting welfare benefits into performance-based attractive employment social insurance schemes

There is no fringe benefit as welfare distributed to employees in the company, except for employees' canteens that provide a variety of foods for employees for lunch at a price of actual food costs. The company does not have obligation to offer housing to employees. Instead, housing allowances are provided in proportion to the employee's salaries.

Yet, the company maintains obligations in payment of employees for their pension premiums, unemployment insurance, medical insurance premiums, and housing funds as required by the government social policy. In addition, the company provides the core employees with the complementary pension and medical care schemes. In other words, only senior employees are entitled to additional pension premiums that are tied to the work attitude assessment results each year. Besides, additional medical insurance schemes are offered to employees who have excellent performance and contribution to the company. Senior executives and distinguished technical personnel can enjoy most favorable health rehabilitation services in addition to complementary health insurance schemes.

Discriminate social policy in favor of the core employees, coupled with differential compensation practices, serves as a means of retaining and attracting highly qualified personnel into the company. To some extent, the social policy serves as functions of the stabilization of employment relations in the company that might otherwise interrupt business continuity arising from drastic labour turnover. In effect, turnover of the core

employees has been very low in the company as compared to local other companies. On the other, the unique corporate culture and ample career opportunities induce employees to choose a long stay with the company, and commit to their jobs.

Despite the general trend of narrowing down the scope of social benefits in all the firms studied, some welfare items remain and are used to reward key personnel for their long-term commitment to firms. For instance, company houses are not distributed as a welfare benefit in all the firms studied any more. Instead, the provision of company houses is widely used as a means of attracting and retaining outperformed employees. This is particularly prevalent in the state firms studied subject to the state wage guideline policy, where the company houses are regarded as the most effective means of rewarding and retaining skilled young employees. Hence, company houses in state firms are no longer distributed as welfare on seniority (see PhW-2).

Case study PhW-2: Housing serves as a reward instead of welfare
As a state firm, the company is still obliged to provide housing for employees at a subsidised price, but the criterion imposed is shifted from one's seniority or length of service to his performance and contribution. Outperformed salesmen and outstanding technicians are most favourably biased in receiving a company flat over others. In other words, housing offer is becoming an important component of compensation.

Case study PhW-4: New tenets for employment-related social benefits
Being a private firm recently created on green-field site, the company has very limited social benefits offered for its employees. Higher wage rates practiced in the company allow its to narrow down fringe benefits comfortably without the fear of grievance.
The company does not have employees' canteen, kindergarten, and hospital, as is the case in SOEs. Yet, some forms of social benefits do offer to reward employees for their commitment. For instance, the company grants a large sum of housing funds to lengthy service employees that are incorporated into their wage payments. In addition, housing provision by the company is awarded at a subsidized price to exceptional employees for their excellent performance. Here, housing serves as an effective means of retention because the occupant becomes a real owner of the house only after he pays a discounted amount from his salaries for a long period of time.
Medical insurance is offered to formal employees that have their personal files brought in the company, and who have, according to the interviewed human resource manager, a contract of one to two years. The company does not need, although it claims, to pay formal employees for their pensions to the external special pension agency. Because a majority of the employees are recruited from local other units where they possess a house, pensions, and medical insurance. Therefore, this renders the company save a large sum of overhead social costs for its employees afforded by local other units where people left away. In addition, the company hires

thousands of the salesmen on a temporary base without contracts each year. These temps are not necessarily covered by social insurance according to the Labour Law.

For key managerial personnel and technical experts, the company, however, offers fairly generous social benefits including housing, cars, medical insurance, unemployment insurance, and pensions, in addition to stock options. The purpose of the generous benefit offers is aimed to retain key employees by wining their *mind and heart*. This small number of the core employees is, as the case envisaged in Atkinson's (1984) flexible model, surrounded by a large number of short-term employees who are used as flexible as possible for cost effectiveness.

Expressed in the words of a manager interviewed, "We offer out best employees highest wages, and most attractive social welfare in the local labour market, we expect high commitment, and high quality of their performance in return." Moreover, the company has a bus fleet to transport employees from their homes to the workplace every day.

Regional differences play a role in shaping social insurance schemes to the constituent firms. As social insurance schemes are being established in all the enterprises at local levels, the coverage and the penetration of social insurance schemes differ greatly between Shenzhen and Wuhan. Firms located in inland Wuhan (except for a private firm PhW-4) have wide coverage of social insurance for their employees, whereas firms situated in SSEZ only have fragmented social insurance coverage of their employees.

Age of the firm makes differences in its social insurance coverage, which links to the ownership of the firm, eventually to the institutional heritage. In general, old state firms are most willing to shift pension burdens to the state social insurance agency due to aged employees on average. In contrast, newly created private firms are reluctant to participate in pooling social insurance funds because managers believe that relatively young workforces employed in the firm do not have so much emergent needs (i.e. illness, retirement) in sight. However, in all the investigated firms, social insurance programs are only selectively applied to those employees who are perceived as the core workers, verified by formal labour contracts, whereas migrant workers (in the cases of PhS-5, and PhS-6) as well as peripheral workers (in the case of PhW-4, PhW-2) are not covered in social insurance programs.

Case study PhS-5: Selective social benefits offered to the selected employees

The company only provides housing to incumbent employees, or sells the company's houses to them at a subsidized price. For the newly recruited key employee, a single room is offered to him/her if he/she is willing to stay with the company for a longer period beyond the length of labour contract. In any case, the company is not obliged to offer a house to every employee. Instead, housing funds are provided and incorporated into individual employees' wage payments. Yet, the company continues to selectively offer housing to key employees as a reward for their exceptional performance, or contributions to the success of the company.

> To a great extent, housing is no longer distributed as welfare, rather, serves as a means of retaining or rewarding key personnel.
> Employees' pensions and insurance premiums (including medical expense and unemployment) are formalized and taken over by specialized agencies external to the company. What the company needs to do is to pay a certain amount of the total wage on the payroll for their employees to these agencies. Since not all the workers employed in the company (especially migrant workers) are regarded as non-formal employees, those workers without residence permits are thus excluded from enjoying various insurance schemes. In other words, the company selectively applies pension and other insurance schemes to certain segments of the key employees.

To sum up, enterprise-based comprehensive social welfare systems prevailed in the old state firms studied were cut off, and the remaining is being drastically transformed to one designed for rewarding employees for their commitment and performance. Private firms, as well as newly created state firm included in the study, tend to limit the scope of social welfare coverage to their employees, or directly incorporate it into employees' payment packages. This development does not mean that the newly emerging social insurance schemes have indiscriminately extended to cover the entire workforces in the organization.

As revealed in this research, most state firms studied have substantially reduced the scope and types of welfare benefits in order to cut costs, as well as to forge new incentive systems. Some of the welfare facilities are externalized to markets, while the remaining employment-related social benefits are increasingly linked to compensation for employees' motivation, commitment, as well as to the development of corporate culture. In the non-state firms studied, social insurance packages are designed to cater for the workforce on a selective base in the sense that only the core employees are covered while migrant workers, or workers without contract are excluded. Hence, the difference in the coverage of social welfare provision is narrowing down between state firms and non-state firms. Accordingly, a trend of convergence is emerging that is towards performance-related welfare provision in all the firms studied.

Reinstitutionalization of welfare systems contributes the convergence of welfare provision between the state firms and non-state firms included in the study. The emerging social insurance scheme advocated by the government is aimed to establish an external social security network at the local level, whereby detaching the cemented employment relationship between employees and their employing firm. This effort helps to bring in flexible employment relationships between employees and their employing companies. Although state firms find it hard to transform their welfare provision consistently with other HR components, employment-related social benefits are no longer distributed as seniority-based welfare for every employee. Private firms are instituting employment benefits into rewarding employees for their performance, or as a means to retain the core employees, or as a characteristic feature of the corporate culture caring for employees.

6.3 Discussion and evaluation

As set out at the beginning of the chapter, internal consistency or complementarity of HR practices and policies need to be maintained if the firm intends to elicit flexibility and high performance from the workforce. To the extent that the firm's HR practices and policies signal unambiguous and consistent messages in main of HRM activities, the workforce shall have a clearer, and more powerful sense of what they can expect, and what is expected of them, particularly with respect to flexibility and long-term commitment.

Empirical evidences revealed from this chapter clearly show that market-oriented transition in China's economy has led dramatic changes in HR systems at the company level, while continuities of old personnel practices remain, especially in old state firms included in the study. As a result, the assumed internal consistency of HR systems is not fully maintained in organizations, and inconsistency most likely arises in state firms that are locked in half-the-way transformation.

First, all the state firms studied, as shown in the chapter, have not yet acquired full discretion over personnel recruitment and selection. Occasionally, local governments assign retired army persons to state firms, regardless of actual needs of the firms. Frequently, local governments (i.e. the principal) continue to appoint state firms' top managers (i.e. agent), whose next appointment may not fully rely their merits but political accountability. The labour assignment and management appointment through the government is extremely incompatible with labour market practices, which poses adverse impacts on the morale of the workforce whose entry differs from government assignment. In this regard, private firms enjoy full personnel discretion of managerial staff recruitment, using a broad source of selection including individuals' networks, and occupational labour markets (e.g. local Talented Exchanges).

Second, although the *labour contract system* has been unexceptionally implemented in all the investigated firms. Yet, the lengths of contracts offered to employees vary with firms and regions. In the private firms studied, management tends to offer their employees relatively short-term labour contracts, whereas state firms usually give long-term contacts to employees. The difference in the length of contract reflects different governance of employment relationship and historical legacies of the companies under a changed business context. Old state firms, due to liabilities of age, usually have a large proportion of old workers that need downsizing but are difficult to carry out. Therefore, as state firms attempted to convert the long attached workforce into a contract base, most of the employees automatically acquired a long-term contract in light of the Labour Law. In contrast, the private firms studied, as well as newly created state firms, being later comers, have employed relative young workers on the short-term contract base, implying adaptability and flexibility. Hence, private managers are not confronted with the same problem as SOEs in converting the existing employees to a contract base. Moreover, relatively short-term labour contracts in private firms enable management to secure more flexible labour practices in the workplace. Although longer-term labour contracts seemingly allow state firms to retain some key employees with firm-specific skills in the organizations, thereby reducing unwanted labour turnover, however, the evidence reveals another trend: state firms tend to offer short-term contracts to newly recruited workers.

Therefore, there are a variety of contracts differentiated by length of employees' service in state firms. This is in contrast with a unitary form of labour contracts adopted in the private firms studied, where flexible contacts are mainly applied to different segments of the workforce on the skill base (e.g. TeleS-2, and PhW-4).

Thirdly, *reward systems and compensation* have become flexible in all the firms studied. However, the principle of compensation on which different reward components are built upon differs between state firms and non-state firms. While seniority still carries a weight in state firms' compensation of employees, private firms reward employees mainly for their performance, skills, and job positions, or the combination. Moreover, managers of private firms enjoy greater flexibility than their counterparts in state firms in determining the scale and types of employees' compensation. State firms, in contrast, have to follow the state wage regulations of linking remuneration to its profitability. Moreover, newly created firms (mainly private firms) can offer higher rates of wage to employees that turn on *efficiency wage effects* in organizations. Higher wage rates in these firms, in turn, enable management confidently to pursue labor flexibility at the workplace without the fear of employees' resistance or shirking. In addition, higher wage rates can attract more qualified applicants from labour markets into the company for selections than expected. In this sense, lower wage rates prevailing in elderly state firms located in inland city Wuhan would deprive management of much potential for pursuing labour flexibility in organizations. Obviously, low wage rates might push best employees to leave the company especially when career development prospects turn out to be bleak. This is why skilled young workers tend to voluntarily leave the declining firms.

Fourthly, *training and development* is not adequately addressed in all the firms studied. Rather, a trend of convergence emerges between state and non-state firms in limited training commitment. Often, management often sees training as a gift through which to enhance loyalty or efforts, instead of the main means to upgrade and expand employees' skills. Even if limited training is occasionally organized in the company, the training is targeted at newly recruited workers for procedure rules. In particular, most of the existing training and development programs are narrowly defined and fragmented, lacking of a coherent linkage to functional flexibility at the workplace. In addition, the emphasis of the most in-house training programs is put more on procedural rules than on substance of job skills. Out-house training is organized, occasionally, for managerial and technical employees, in collaboration with local universities (mainly private firms), or government supervising agencies (mainly SOEs). By and large, management's commitment to employees' training and development is heavily influenced by local labour market conditions that remain regulated by the local governments. The limited training organized in-house is consistent with a selective recruitment process as observed in all the firms studied, with an emphasis on bringing in young qualified entrants from external labour markets.

Last, employment-related *social benefits and coverage* are undergoing drastic changes toward building up a social security network at the society level in all the firms studied. Differences in the extent of social benefit changes still exist between the state firms and non-state firms included in the study. In the state firms studied, the past prevailed wide range of welfare benefits were substantially cutting off. And the remaining welfare benefits

are increasingly integrated into employees' performance-related rewards. In the private firms studied, management begins to set up employment-related social benefits from zero up to the level as required by the Labour Law. The 1990s emerging social insurance program (i.e. five funds, see chapter 2) initiated by the government facilitates to bring up the convergence of the two opposite trends: cutting off the old social benefits in SOEs, and instituting social insurances in private firms. The end objective is to build up a social security network built up in society, although now started at the local level. In the race to set up social insurance schemes to employees, the non-state firms move ahead o the state firms included in this study. Private firms (e.g. PhW-4, and TeleS-2) carefully design the provision of social welfare benefits to maximize management control over labour and to lock the core workers into the generous firm-tailored social insurance programs that make them leave costly. In particular, some of the non-state firms (e.g. TeleS-2, and TeleW-1) attempt to pick up social benefit that is being cut off in state firms (e.g. housing provision) for their employees (e.g. TeleW-1), or offer employees generous extra social insurance programs (e.g. TeleS-2, and PhW-4). By differentiating themselves from their counterparts in SOEs, private managers intend to attract and retain qualified workers for a long-term commitment, or to enhance corporate identity of the workforce in organizations.

By and large, changes in HR systems are dramatic, and there are many emerging trends (not necessarily convergent, sometimes divergent) in concrete HR policies and practices among the firms studied situated in the two cities. Together, it is plausible to conclude that internal consistency of HR systems is more or less maintained in the non-state firms, while internal consistency of HR systems is no yet in place in the state firms included in the study. Moreover, firms situated in Shenzhen have adopted more market compatible HR practices than firms located in Wuhan. No significant difference is found between the two industrial sectors that affect the firm's HR system in terms of consistency.

Based on the empirical findings on the five policy areas examined above, the relative positioning of the eight firms studied can be depicted along the dimension of consistency-inconsistency of HR systems on one hand, and the dimension of transition process on the other[31] (see Figure 6.2).

Obviously, inconsistency of HR systems is most evident in old state firms (e.g. PhW-1, and PhW-3) where part of HR policies are transformed to market practices while the remaining is still locked in legacies of the past state plan. As pointed out in the above empirical analysis, inconsistency of HR systems arise most likely in three policy areas of the firm's HRM activities: recruitment and selection, labour contract, and reward system. These three areas are the state firm's HRM activities that the state interventions remain, and legacies of the past state plan-based practices continue to work.

[31] Accurately pointing out the exact position of each firm's HR system in Figure 6.2 is hard, and not necessary, at least for the empirical analysis of HR systems based on case studies.

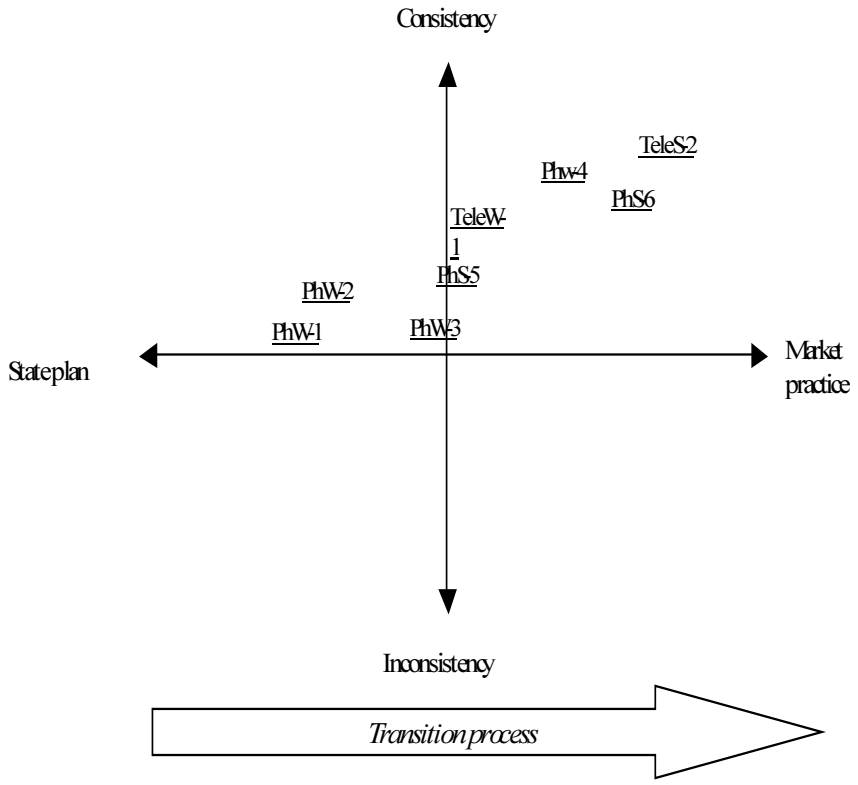

Figure 6.2. Relative positions of the eight firms' HR systems in transition

Despite inconsistency of HR systems in old state firms during the transition process, *single-employee consistency* is largely maintained in all the firms studied when referred to Baron and Kreps' (1999: 41) three layers of consistency. As shown in this chapter, the most firms studied tailor HR policies and practices (recruitment, employment contracts, training, and compensation) to individual employees who are differentiated by ages, skills, work experiences, and job positions. Comparatively, *among-employee consistency* is less evident in all the firms studied since Chinese managers tend to differentiate the workforce in terms of skills, and job positions. This is reflected in the length of employment contracts, training priority, compensation, and social insurance coverage that vary among the employees in the same firm. Such inconsistency among-employees conform to two flexibility strategies often sought in the firm: functional flexibility is attempted in the core workforce while numerical flexibility is expected from the peripheral. *Temporary consistency*, which implies continuity of the firm's HR philosophy over time, is observed in all the firms studied. In the state firms studied, temporary consistency also points to organizational inertia linked to the past institution legacies that retard the subsequent transition into market practices.

On the other hand, inconsistency in HR systems entails management's a strategic choice in *buffering* and *bridging* adverse impacts under China's changing institutional environment. As noted in the chapter, state managers as an agent of the state, need to cope with various external and internal constraints (e.g. state wage guideline policy, the state personnel assignment and management appointment, hardening budgets, outsourcing, and legal regulations) that the firm often faces. In order to survive intensifying competition, state managers turn to downsizing of redundant workers, by seeking the government support. Meanwhile they have to accept personnel assigned by the government. Even in all the private firms studied, the Communist Party office is set up in the organization to enhance the legitimacy of management, as well as to maintain good relations with the local government officials. Obviously, the creation of Party Office in private firms is beneficial to managers to minimize adverse effects from the unpredictable business environment. It can at least bring three types of benefits to top managers in private firms: 1) to build up an image of legitimacy in society, 2) to gain an official recognition from the local government, 3) to get rid of predatory harassment from arbitrary external supervising officials. In other words, establishing Communist Party Office in private firms is a strategic choice that the top managers attempt to obtain what is needed and what is to avoid under a transition context. This strategic "*buffering and bridging"* can be partly ascribed to management's reaction to the powerful isomorphic processes of the institutional coercion and mimicry on its constituent firms (DiMaggio and Powell, 1983). However, private firms tend to deny access of trade unions (see chapter 4) as top management intends to keep more room for flexibility (e.g. overtime working). This is in contrast with the state firms studied, where trade unions are present as required and the unions' chairman (appointed by the government) sits on the board when important personnel events (such as layoffs, firing) arise in the firm.

Most evident managerial strategic choices are observed in the area of rewarding and compensation. As noted above, state managers need to follow the state wage guideline policy when rewarding employees. In Shenzhen, both state and non-state firms formulate flexible reward systems that successfully avoid the state wage regulations. This is in contrast to reward systems adopted by firms located in the inland city Wuhan, where state managers continue to pay employees service wages and various subsidies ranging from transports, food, and newspaper subscriptions, justified by the local government.

Despite the differences in HR systems between state and non-state firms, each firm under this study has formulated a set of distinct HR systems and policies that facilitate (or impede) the implementation of flexible labour practices at the workplace. To a great extent, the observed inconsistency of HR systems is mainly shaped by the firm's surrounding institutional environment where management strategic choice matters and works.

6.4 Conclusions

This chapter has examined changes and continuities of HR systems in the eight firms studied from the consistency perspective. It is observed that substantial changes have occurred in the firms' HR systems that come to support flexible working practices adopted

at the workplace. By and large, all the firms studied are actively involved in selective recruitment of skilled and unskilled labour on labour markets, using the candidate's education credential, age, work experience, and resident permit as selection criteria. Managers and firms tend to vary labour contracts, salaries, training programs, and welfare schemes to workers who are differentiated by their human capital, skills, and job positions. Usually, the peripheral workers are offered relatively short-term contracts, time wage rates, little training, and less welfare benefits to achieve numerical flexibility and higher mobility. The core workers are provided with relatively long-term contracts, attractive salaries and bonus schemes, training for promotion, and social welfare programs to increase their functional flexibility. These differentiated HR policies and practices in the company facilitate management's efforts to increase labour flexibility and mobility at the workplace while keeping the core workers to stay as long as possible with the organization.

On the other hand, continuities of the past personnel practices remain evident in the most state firms studied due to constraints associated with the past institutional legacies. The pace of change and the extent of continuities remained differ among the firms studied that gives rise to inconsistency in HR systems in state firms.

Inconsistency of HR systems is most evident in the old state firms studied where part of HR practices is transformed to market practices while the remaining is locked in the past personnel practices based on the state plan. Comparatively, the newly created firms (mainly private firms) have drafted market compatible HR policies and practices that exhibit internal consistency. Inconsistency of HR systems observed in the state firms can largely be ascribed to institutional constraints and organizational inertia, which entails management strategic choices in *buffering* and *bridging* adverse impacts of constant deinstitutionalization and reinstitutionalization stemming from the market-oriented transition in the economy.

Nevertheless, positive changes in the firm's HR system provide management with the necessary tools to seek flexible work practices at the workplace. Among changes in HR systems, labour contract systems set out a legal framework for management to attempt various types of labour flexibility in organizations in response to market competition. Subsequently, flexible reward systems, by tying individuals' compensation to their performance, as well as to profitability of their companies, help management implement various flexible working practices in organizations. Performance-related social benefits enable management to seek the long-term commitment of key employees to their organization in parallel with labour flexibility. In addition, the strategy of selective recruitment in all the firms studied indicates management's attempt to attract qualified manpower into the organization. However, inadequate employees training commitment is found in all the firms studied, where management tends to rely on labour markets for the supply of required skills, due to higher transaction costs of in-house training.

The most striking differences are observed in the areas of recruitment, labour contract, and reward systems between state and non-state firms included in this study. As compared to the state firms studied, the non-state firms recruit new employees from a wider array of labour markets, emphasizing the candidate's education attainment, age, and skills.

Relatively uniformed short-term contracts are offered to employees who are well rewarded with higher wage rates. To a great extent, the differences can be attributed to external institutional constraints that differ in terms of ownership of the firm and labour market conditions. In this respect, the private firms studied enjoy double advantages over state firms in drafting consistent HR systems compatible with market practices. First, private firms, being newcomers, employ relatively young workforces that can be utilized more flexibly than in state firms. Second, private firms have greater freedom than state firms in coping with the unpredictable policy environment, because private managers are not subject to the state wage policy, or to less extent to other state HR policies. Despite this, all the private firms studied set up the Party office in organizations to enhance legitimacy of management, as well as to maintain a good relation with local government officials. While the access of trade unions is denied in the private firms, given that fact that trade unions in all state firms studied occasionally voice workers' grievances against management's decisions on firing and laying off. Nevertheless, HR systems in all the investigated firms have moved towards labour market practices under constraints.

Chapter Seven

Downsizing and Flexibility: Two Special Cases[32] (Empirical Findings III)

> *"Some state-owned enterprises were persistent loss-makers and the only way that they could be made to operate more efficiently was to force them to reduce their excess labour inputs (or, alternatively, to go out business altogether). In other words, they had to make some of their workers unemployed."--- David J. Pyle (1997: 90).*

Introduction

This chapter reports empirical findings on laying off practices, one of the most radical flexible forms, in China's state sector in the mid-1990s. The research focuses on the drive, process, and outcome of downsizing with respect to labour flexibility in two state-owned heavy machinery manufacturing firms, from the management perspective.

The empirical evidence presented here was collected from case studies of the two state firms (i.e. MW-1, and MW-2) chosen from Wuhan. The selection of the two state firms in the machinery industry was based on two considerations. First, the manufacturing industry had long been regarded as the backbone of economy by the government, requiring the dominance of the state. Second, and related to the first, most SOEs in the machinery industry are gargantuan, with a strong reliance on the state support of input supply and output procurement. As the recent reform exposes SOEs closely to market forces, the reliance on state support, e.g. subsidies, became increasingly unaffordable. The move to downsizing is illustrative of the withdrawal of the state and the introduction of market mechanisms in SOEs. It can be expected that downsizing in SOEs in this industry have profound impact on personnel management in firms.

The body of this chapter consists of four parts. It starts with a brief literature review of downsizing in relation to flexibility (part I). The second part presents empirical downsizing practices in the two state firms studied in China's machinery industry, with reference to Cameron's (1994) framework, reviewed in part I. This is followed by a discussion of

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[32] This chapter is the revised text of an earlier publication in JEEMS by the author (Chen, 2001).

problems associated with downsizing (part III). The chapter ends with concluding remarks related to general knowledge on HRM and downsizing (part IV).

7.1 Downsizing and flexibility: An overview of the literature

In the management literature, downsizing is a widely used term with broad connotations. Downsizing, when seen from the *industry level* perspective, usually involves managerial actions of mergers, acquisitions, joint ventures, and market strategies of focus or diversification (Baron and Kreps, 1999; Caves and Porter, 1977; Porter, 1985; Duffy, 1990). Dewitt (1993, 1998) distinguishes three types of measures that a downsizing firm normally takes in response to the industry's constraint shift: *retrenchment, downscaling*, and *downscoping*. Retrenchment refers to 'shrinking' firm's attempt to maintain and strengthen its market position through centralisation and specialisation of production (Dewitt, 1993). In contrast, downscaling and downscoping represent 'partial exit' strategies by which a shrinking firm gives up competitive space and leaves gaps for incumbents or new entrants to pursue. The three identified downsizing actions "can be viewed as alternatives along a broad strategic choice continuum ranging from staying in to leaving an industry" (Dewitt, 1998: 59).

From a strategic choice perspective, downsizing can be seen as a managerial response to drastic changes in the business environment. Child (1972: 2) defined *strategic choice* as "the process whereby power-holders within organizations decide upon courses of strategic action." And "such action could be directed towards different targets" (Child, 1997: 45). For instance, external oriented actions may include a move into or out of given markets, or secure a favourable transaction term with external partners. Whereas internal actions may involve an attempt, within the limits of resource availability and indivisibility, to establish a configuration of personnel, technologies and work organization that is both internally consistent and compatible with the scale and nature of the operations planned. In this sense, Freeman (1994) perceives downsizing as a process of organisational change towards either *convergence* or *reorientation*. By convergence, downsizing implies incremental change and adaptation of a relatively long time span, whereby the current way of doing business is reinforced or "…a desire to do the same things better" (ibid., 1994: 216). Reorientation, on the other hand, involves "simultaneous and abrupt shifts in strategy, power distribution, structure, and control systems" or doing different things in the organisation (ibid.,1994: 215). Here, downsizing is seen as organizational changes intentionally initiated by management in order to contain costs, to enhance profit revenue, or to bolster competitiveness.

More often, downsizing is carried out at the organisational level as a cost reduction strategy when the firm encounters severe economic hardship. Cameron (1994: 192) defines downsizing as "a strategy (intentionally) implemented by managers that affects (a) the size of the firm's workforce, (b) the costs, and (c) the work processes". Accordingly, Cameron (1994) identifies three types of implementation strategies of downsizing: *workforce reduction, work redesign,* and *systemic change* (see Table 7.1).

The *workforce reduction strategies* focuses mainly on eliminating the number of employees, while the *work redesign strategies* focuses on reducing work in addition to or in place of reducing the number of workers. In contrast, the *systemic strategies* stress not just changing the size of the workforce or the work, but also changing the organisation's culture and the attitudes and values of employees. Obviously, each type of downsizing consists of a set of different actions that can be executed in a different manner. For most downsizing firms, the three identified implementation strategies are not necessarily mutually exclusive since the primary goal of downsizing is to improve "organisational efficiency, productivity, and/or competitiveness" (Cameron, 1994: 192). It can be implemented either as a defensive reaction to market share decline or as a proactive strategy to enhance organizational performance (Miles and Snow, 1978).

Table 7.1. Three types of downsizing strategies

	Workforce reduction	**Work redesign**	**Systemic**
Focus	Headcount	Jobs, levels, units	Culture
Eliminate	People	Work	Status quo
Implementation time	Quick	Moderate	Extended
Payoff target	Short-term payoff	Moderate-term payoff	Long-term payoff
Inhibits	Long-term adaptability	Quick payback	Short-term cost savings
Examples	Attrition, layoffs, early retirement, buy-out packages	Combine function, merge units, redesign jobs, eliminate layers	Involve everyone, simplify everything, bottom-up change, target hidden costs

Source: Cameron (1994): 197.

In recent years, organisational downsizing has gone in hand by hand with management's effort to pursue labour flexibility in organisations (Nelms, 1997; Smith, 1994, 1997; Asian Business, 1996). Downsizing "becomes a way of life for managers as they continuously seek ways to do more with less" (Freeman, 1994: 234). Usually, management tends to downsize the number of permanent workers who are surrounded or replaced by a growing presence of a large number of contingent workers subject to market fluctuations. Subsequently, the constant hiring and firing policy toward the contingent workforce signals what can happen to the shrinking permanent workforce. The workplace reality is therefore increasingly segmented by a large proportion of the workforce that is either under-employed (part-time), or over-employed (for instance, core workers), or trapped in unfavourable job situations (e.g. temps). Frequently, peripheral workers function as a buffer for a shrinking number of core workers (Atkinson, 1984). Apparently, downsizing, when coupled with flexibility, will lead to intensified work, and tighter labour control.

In China, downsizing came into fashion very recently only when the Party Congress made it the national guideline for medium- and large-sized state firms in 1997[33]. To date, reports about layoffs in Chinese downsizing state firms can be found in the domestic and international media (e.g. Economist 21st 1998b: 63; Beijing Review, 1998c; People's Daily, March 24, 27, 1998, August 8, 16, 19, 29, 1998, Oct. 4, 1998). Within a short period of time, and as an unprecedented experience, many state workers have seen themselves redundant for the first time[34]. Downsizing not only led to massive layoffs that pushed unemployment to a record high[35], but it also gave rise to enormous physical and psychological traumas to the new class of 'unemployed' job losers while state assistance is lacking.

Flexibility represents the ability to change or react with little penalty in time, effort, cost or performance (Upton, 1994). Here, flexibility of labour has numerical and functional dimensions. In brief, *numerical flexibility* is the ability of management to vary the amount of labour input at short notice. This can be done either externally by contracting out work or by the use of temporary workers, or internally by modifying working time patterns to fluctuation in volume of work. *Functional flexibility* concerns the versatility of employees to work within and between jobs. This can involve either vertical integration of different task components (i.e. job enrichment) or horizontal integration of task components at the same skill level (i.e. job enlargement). From the management perspective, both the types of labour flexibility serve to contain costs, to fully utilise labour, to accommodate fluctuations in production and service circles[36]. And as such, greater flexibility has become one of three primary objectives of downsizing in parallel with *higher productivity, better stock performance* (Cameron, 1994; Dewitt, 1998; Mishra et al, 1998).

To sum up, organisational downsizing often occurs when firms encounter harsh economic climates. The purpose of downsizing is to cut costs and boost organizational efficiency, competitiveness, and flexibility. Downsizing usually involves similar workforce reduction tactics such as transfers, outplacement, retirement incentives, and layoffs. Workforce reductions will then affect "work processes, wittingly or unwittingly" (Cameron, 1994: 193), further leading to some kind of work redesign (such as restructuring or eliminating work, abolishing hierarchical levels, merging units, or redesigning tasks). All in all, downsizing is more or less related to reduction of the size of the workforce and reflects a shift from the frequently prevailing organisational ethic that 'bigger is better'. To put it differently, the business cycle risk is shifted to the workforce, as opposed to the past in

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[33] The Chinese President Jiang Zeming in his speech to the 15th Party Congress in October 1997 proclaimed an overhaul of state firms through downsizing redundant workers in order to rejuvenate the state sector in the end of the century.

[34] It was reported that in 1997 around 11.5m workers were laid off, of which 7.8m were from state firms. Additional 3.5m workers would be laid off in 1998 (Beijing Review 1998c: 18).

[35] By 1997, officially registered urban unemployment rate climbed to 3.1 percent, the highest since 1990. If included unregistered jobless in both rural and urban areas, unemployment rate rose to 26 percent in 1997 (see, Yang Yiyong (1997).

[36] It is observed in the US and in the EU as a whole that the growing number of people are hired and let go on a contingent basis (OECD, 1998: 160-63; Smith, 1997).

which due to permanent employment in the context of internal labour market policy, the economic risk was borne exclusively by the firm and its management.

The following analysis takes organisational approaches as developed by Cameron (1994) to examine downsizing in the two chosen Chinese state firms, while referring to other relevant perspectives when needed. Three questions shape the analysis. 1) Under what circumstances was downsizing initiated? 2) How was downsizing executed? 3) What effects has downsizing brought to the firm, especially with respect to labour flexibility? It is hoped to find out, through this study, under what circumstances downsizing took place in China, and how it was implemented, and what effects were achieved after downsizing.

Before the analysis will take up the problem of downsizing in the two firms, a short overview on the economic reforms is needed in order to understand the economic problems and institutional constraints that shape the downsizing policy in China.

7.2 Downsizing in China's machinery industry

7.2.1 Background of downsizing

Prior to 1978 market reforms, China's heavy industry expanded under a well-shielded environment (Child, 1994). The dominance of state-owned machinery manufacturing firms in the industry was particularly emphasised as it regarded as the mainstay in the economy (Murakami and Liu, 1996). Yet, from 1992 onward, the country's machinery industry encountered increasing challenges under a changed business environment. First, the state gradually reduced the scope and number of products regulated by state plans, while the majority of production was exposed to market transactions outside the state plans[37]. Second, the domestic machinery market was increasingly opened to international competition under the framework of the "*open-door*" policy. Subsequently, a large amount of imported machinery goods poured into China that took over 43.29 per cent of the domestic market during 1990-95 (IIER, 1997: 84). As a result, 30 per cent of the Chinese machinery industry's capacity turns out to be idle in the sea of imported goods (IIER, 1997: 90). The excess production capacity in turn triggers off intense price competition that drove the profit margin of the industry to a history low record (IIER, 1997: 86). Thus, it is unsurprising that the growing number of SOEs incurred operational losses. The total amount of losses in state-owned machine manufacturing firms rose to RMB 5700 million yuan in 1996, accounting for 39 per cent of total profits and taxes they delivered to the state (IIER, 1997: 86).

In order to reverse the trend of the growing operational losses in SOEs, the government has taken many reform measures to rejuvenate the state sector. These include profit retention, profit taxation, the contract management system, and corporatization (see Table 7.2).

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[37] By 1996, the government mandatory purchase order in large-sized power station manufacturing and some key components of car manufacturing accounted for less than 5 % of the total sales turnover (IIER, 1997).

Among the reform measures the implementation of the contract management system and recent corporatization are particularly significant and still under practice in many large SOEs. They deserve a further discussion here before proceeding to examine the two selected SOEs in the machinery industry.

The Contract Management Responsibility System (CMRS) was formalised in the mid-1980, yet widely implemented in large SOEs only after 1987. It was essentially a kind of target management or management by objectives (MBO). The CMRS was designed to change the hierarchical bureaucratic relationship between the state and the enterprise into a contractual one in which the government and management are linked by the contract. It involves 'the specification of items such as the amount of profit remittance, investment and technical innovation targets and the tying of wage bills to total profits' (Fan, 1994). However, the CMRS failed, as this study will show, to deter management from pursuing their individual interests (e.g. through externalising operational costs with less or no distraction of depreciation costs). Frequently, it encourages short-term behaviour at the expense of long-term growth, as there was no hard budget constraint that had to respect (Fan, 1994).

Table 7.2. Chronology of selected reform measures on SOEs, 1978-

- 1978-80 Launch of economic reforms and 'open door' policy
- 1982 Workers' congresses set up in 95 % of large state firms
- 1983 Profit retention and bonus payment scheme introduced
- 1984 Substitution of profit remittance for profit tax
- 1984 New law on enterprise management in urban factories
- 1985 Enterprise Responsibility Contract System introduced
- 1986-87 Labour contract and wage reforms put into practice
- 1988-92 Wide spread implementation of Contract Management Responsibility System
- 1990-91 Policy of economic retrenchment, i.e. contractual monetary and fiscal policy
- 1992 Deng Xiaoping's south China tour on renewal of economic reforms
- 1993 Establishment of modern enterprise system (i.e. corporatization), in line with socialist market economy. Labour contract coverage extended
- 1994 New Labour Law starting with 1995 promulgated.
- 1995 'Grasping large & medium-sized firms and let floating of small-sized firms' – policy formulated.
- 1996 Mergers, acquisitions, start as do cases of bankruptcy
- 1997 Downsizing and layoffs

Source: with reference to Warner (1995)

From 1994, new approaches were sought for reforming SOEs, especially at local levels. These include mergers, leases, corporatization, worker and management buyouts, and bankruptcies (World Bank, 1997). These new reform measures were attempted to change the corporate governance structure: 1) to clarify asset rights, and assignment of liabilities; 2) to provide a reasonable balance of interests among owners, creditors, and managers. The former requires a clear separation: legally and operationally, between the government (as

owner) and the firms (as business entities). The latter embraces a western corporate business system so that the owner can select a board of directors that, in turn, oversees the daily operations of the professional management.

These new approaches to reforming SOEs, however, pose a dilemma for the Chinese government: those who could serve as professional managers know which assets or firms can quickest and at low costs turn into a profitable business. For this reason they will offer lease contracts for part of all state controlled industrial assets only. Subsequently the government succeeds in leasing out the most valuable assets, but gets stuck with those assets that can be turned into profitable business at high costs only – or for which there is no demand. The result is that the government owns fewer industries, something that is aimed at. The few in its hand are those that run the highest losses and that need to be financed by the general taxpayer[38]. In addition, corporatization has also induced management to maximise intra-firm consumption by offering rewards and welfare benefits for all employees including themselves at the expense of outside shareholders and the state budget. In the end, state enterprise assets would gradually be siphoned into private pockets, leaving the government to assume the liabilities for the worst cases (World Bank, 1997). This is a widely known phenomenon in Eastern Europe.

One often overlooked reason for the unsatisfactory SOE reform lies in the fact that most SOEs, especially in the heavy industry, tended to grow to a large size and embraced a comprehensive scope of social service functions (such as housing, hospitals, schooling, and kindergartens) (Murakami and Liu, 1996). These social and welfare provision activities considerably constrain the enterprise to realise its commercial goals in the face of competition from non-state firms (Wood, 1994). Such social function characteristics make the application of any reform measures particularly void in this industry. Without transfer of pension, health, and education obligations from state firms to government bodies, state firms cannot be turned into competitive ventures. Recently, some local governments have taken major steps to relieve enterprises of these social burdens by removing them[39]. But such developments are fragmented, and uneven across regions and industries. In most cases, the firms are still strangled by excess workers that are tightly cemented in their employing organisations. Although a labour contract system was introduced in 1984,

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[38] It was reported that asset stripping and excessive wage compensation are widespread in Chinese state enterprises. A 1994 survey of 124,000 state enterprises found that asset losses and unaccountable expenses accounted for 11.6 per cent of the assets of the firms sampled. One estimate puts the annual loss of state assets at RMB 30-100 billion yuan, or 2-9 per cent of annual capital investment by state-owed units. Half of the new limited liability firms established in Sichuan and Shanghai in the past few years are in the financial sector, which suggests the widespread creation of "shell" firms to drain assets (World Bank, 1997).

[39]Some municipalities in Shanghai, and in Wuhan, for instance, are pooling pension obligations across firms and earmarking payroll taxes for pension, unemployment, and health insurance. Some local authorities are taking over schools and hospitals previously run by enterprises. Another way to reduce the budgets necessary for social benefits is to reduce housing subsidies by either raising rents or selling company's houses to employees (Beijing Review, 1998c).

management autonomy to alter the size and composition of the workforce is still circumscribed by internal and external constraints in the firm. SOEs are still responsible for re-deploying their surplus labour by creating new jobs for them or paying them wages off position (Fan, 1994). This personnel system restricts the enterprise management to adjust manpower, and to develop labour flexibility.

Apparently, downsizing is needed to sort out redundant workers in SOEs. Downsizing whether initiated by mergers or not is seen as an effective way for getting rid of excess labour. The central government particularly advocates downsizing as an effective means to raise labour productivity. Thus, when the Congress of the Communist Party in 1997 claimed to overhaul the management of SOEs and made them profitable within the century, increasing productivity by putting an end to the omnipresent overstaffing stood at the core of the discussion. Prime Minister Zhu Rongji too asserted in his inaugural speech at the National People's Congress (1998) that laying-off redundant workers would be one of the main reform measures toward SOEs. He articulates three concrete steps for downsizing: *laying off so as to divert redundant workers out*; *reducing personnel so as to increase efficiency*; *and implementing re-employment project within the enterprise.* In response, governments at the local level quickly started to force the SOEs under their jurisdiction to implement the downsizing strategy.

The above reform policy background should be kept in mind as the two selected SOEs are presented in the following section.

7.2.2 The implementation of downsizing in the two state firms investigated

A description of the two investigated downsizing state firms is included in Appendix I1. Briefly, the contemporary MW-1 is a specialised industrial boiler manufacturer that was restructured into a quasi-standardised corporation in 1994. The main industrial boiler products are mainly supplied to equip domestic power generation stations, sugar processing factories, cement manufacturers, and paper manufacturers, with few exports to the third world countries in South Asia, Latin America, and Africa. In 1997, the MW-1 had sales turnover of RMB 680 million yuan, employed 6,100 workers. The sales revenues accounted for 15-16 per cent on domestic boiler markets, down by 10 per cent over the past five years due to intensified competition since 1992. In the early 1998, one of the MW-1's thirteen sub-firms was split off to form a joint stock company with foreign partners consisting of investors from Hong Kong and France, as well as of seven domestic financial investment firms as a joint domestic partner[40]. The rest of the MW-1 will, however, remain under the old governance structure, i.e. being subordinate to the local Machinery Bureau.

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[40] It was hoped that the newly formed Sino-foreign joint venture would firstly bring in sophisticated technologies and managerial know-how to consolidate its market position and, secondly, enjoy the favourable policy applicable only to foreign investors. As required, a new internal governance structure in the newly formed joint venture will have to be created in light of the *company law*. By the time of investigating, the new governance structure was not yet implemented.

The MW-2 is one of the largest state owned heavy machine tool manufacturer in China under the parallel administration of the local Machinery Bureau at both the Province and the Municipality level. The main machine tool products are mainly supplied to meet domestic demands, with some product and components exports to international markets, mainly in the Middle East, and South Asia. In 1997, the sales turnover reached RMB104.42 million yuan, employed 4,600 workers (while 7,441 employees on the payroll). Yet, its balance sheet registered a loss of 17.14 million in the same year. The operational loss was mainly ascribed to losing of domestic clients who turned to buying imported machines[41] since 1992, leaving the MW-2 persistently in the red for five years since then. Reducing the scale of losses thus becomes a central task of management under the CMRS that was signed between management and the local government supervisory agency. Due to its unique nature of the products in the national economy, the state still provides necessary financial support, i.e. subsidies, albeit declining. Meanwhile, the MW-2 is under great pressure to become a profitable business entity. In 1996, it was restructured into a corporation in which the liabilities to state banks were turned into equities of the company. Essentially, it remains a state firm without significant changes in property rights in the sense that ownership titles were switched from one state agency (Machinery Bureau) to another (state banks).

The above description clearly shows that the two firms studied faced increasing market competition and government pressures for efficiency gains before they moved to downsizing.

In the face of market competition and government pressure, both the MW-1 and the MW-2 employed more workers than productively necessary. Initial effort to reduce redundant workers in the MW-1 was pushed ahead in the early 1995 through encouraging early retirement among elderly workers. In the MW-2, attempts to cut down the overstaffed workforce were made in 1992 as the 'optimal labour reorganisation' scheme (Warner 1995) was introduced in the company to sort out redundant workers. Yet, large-scale collective layoffs occurred in both the firms in 1997 only when the central government called for downsizing as a means for efficiency improvements in the state sector.

Need for downsizing was further justified by the use of certain efficiency criteria for personnel required. The MW-1 claimed to apply five criteria in calculating the scale of redundant workers for laying off in 1997. These criteria concern: i) efficiency of working hours in relation to total output; ii) empirical calculation; iii) responsibilities and duties (e.g. in personnel department); iv) position-matches (such as cargo drivers that can be decided by the number of trucks); v) ratio determination (such as a fixed proportion of cooks to total number of employees). In this way, 1,201 workers were made redundant and laid off in the company, that accounted for 20 per cent of the total employees before downsizing in 1997. In the MW-2, the scale of layoffs was determined in light of production tasks in relation to market demands, by taking account of projected profits and workload, with reference to the average industry output. Here, several indicators were claimed applicable in calculating the number of employees needed after downsizing. One

[41] The share of domestic machinery products fell to 25% in 1997, as said by the personnel manager interviewed in the company.

of the most important indicators applied was the aggregate profit index on the industry average. The profit index was then discomposed into each plant where the entailed number of employees were calculated out and selected. In this way, 2,233 workers were calculated as redundant employees subject to laying off, accounting for 30 per cent of the total employees before downsizing in 1996 (see Table 7.3).

Table 7.3. Workforce reduction in the MW-1 and the MW-2 in 1997 (in person)

	Pre-downsizing employment size	Post-downsizing employment size	Laid off workers	
	(1)	(2)	Number	As % of (1)
MW-1	6,100	4,899	-1,201	19.7
MW-2	7,441*	4,600	-2,233	30.0

Note: *the number includes 608 old employees that reached legally retired age in 1997.

Despite the claimed economic criteria applied in sorting out redundant workers, identifying target workers for leaving poses particular challenges to management. Not only have workers formed personal relationships with each other during the past stable working environment, but also the applied criteria for manpower cutting are hard to operate objectively. In practice, two types of vulnerable workers were subject to laying off during downsizing in both the firms: 1) *elderly workers*, and 2) *poor performers*. The former was based on the employee's age or length of service, whereas the latter had its ground in individuals' job performance or disciplinary behaviour. Any employee who met one of the criteria set out was encouraged to leave. While the ultimate decision to lay off senior workers was subject to department managers' deliberate calculation, taking into account most likely adverse effects of layoffs on production.

Some government policy restrictions were imposed on management when identifying layoffs in both the firms on social grounds. First, according to the government layoff policy, a married couple, when working in the same company, would not be laid off simultaneously. Even if one partner was already laid off in other state firms, the spouse should be exempted from laying off in the company under the same jurisdiction. Second, retired army veterans were exempted from downsizing even though they were unqualified and poor in performance during downsizing. This type of personnel was assigned into the state sector by the local government as political tasks that are only applicable to state firms. This can be seen as continuity of the past personnel legacies in the state sector. Particularly in the MW-2, the non-layoff policy was also extended to those rural recruits who were employed under the so-called *employment inheritance system* (see Korzec, 1994). This inheritance system holds in the MW-2 that the father, who retires early and settles back in the countryside of his origin, can appoint one of his adult children to take his employment in the company.

During downsizing, elderly workers were most likely to be targets of sacking, although key elderly employees with specific skills were persuaded to stay for a longer service. In the MW-1 all those aged over 50 (for the male) and 45 (for the female) were subject to laying-off during downsizing, while in the MW-2 the targeted elderly workers were five

years older than their counterparts in the MW-1. In both the firms investigated, aged workers were retired early, either ten years earlier (in the case of the MW-1) or five years earlier (in the case of the MW-2) than the legally set retirement age. Poorly performing young workers were sacked as well, but they were in a minority. In the MW-1, for example, 88 per cent of the layoffs (i.e. 1,056 elderly employees) were those retired earlier than the normal retirement age, the remaining 12 per cent (i.e.150 young workers) were laid off as vacancy waiters. The same trend was reported in the MW-2 where 75 per cent of layoffs took the form of early retirement, and the remaining 25 per cent as vacancy waiters. Eventually, laid off workers were among one of the four types of employees: 1) the elderly; 2) the physically weak; 3) female during child breast-breeding period[42]; 4) poor performers resulted either from their poor adaptability or persistent undisciplined behaviour (see Table 7. 4). Not only elderly and weak workers did become the target of downsizing, women at the time of childbirth, as well as the injured were not excluded from downsizing. Except for the first three types of laid off workers that can be objectively justified during downsizing, the last one is subject to substantial management personal judgement and arbitration.

Table 7.4. Criteria applied to, and compensation for, layoffs in the MW-2 and the MW-1, in 1997

Criteria for laying off			**Layoffs and compensation**		
Criterion	**MW-2**	**MW-1**	**Forms of layoffs**	**MW-2**	**MW-1**
1) Performance	Under-performed, unskilled, undisciplined		Vacancy waiter	120-160 (RMB per month)	180-300 (RMB per month)
2) Age & Seniority	≥ 50 for female or 55 for male	≥45 for female or 50 for male	Early retirement	Lower than pensions	600 (RMB per month)
	≥20 for female, or 25 for male (i.e. years of service)				
3) Physical	The sick, injured, disabled employees		Early retirement	Living on special social security funds	
4) Sex	Female workers during the child breast-breeding		Vacancy waiter	75 % of the full job wage	

Accordingly, layoffs took two forms: *internal early retirement* and *vacancy waiters.* The early retirement applied to senior employees or the elderly workers who reached a certain

[42] Child-breeding female workers were temporarily laid off at the time of child-rearing by breast breeding. According to the state regulation concerned, childbearing women are entitled to a leave of absence for 2 years, with the payment of 75 % of their full-time wage rates by the employing company.

age limit that was still lower than the legislatively set retirement age standards. In other words, both the firms adopted '*first-in-and first out'* downsizing strategy towards senior employees who had served for 25 years (male) or 20 years (female). It should be noted that the elderly worker and his length of service might not exactly intersect at the same age, although both were most likely close to pensioners' age set by the law. The second form of layoffs is vacancy waiter. As the term indicates, vacancy waiters are assumed be re-employed preferentially by the company as long as vacancies arise. Moreover, the downsized firms are obliged to help vacancy waiters in finding a paid job elsewhere.

In the absence of social security systems, the two downsizing firms had to provide certain amounts of living expenses for layoffs. The amount of living expenses provision was differentiated, however, between early retirement and vacancy waiters. In both the firms studied, the early-retired workers were better compensated than the vacancy waiters. In addition to receiving standard compensation by their company, the early-retired employees could receive extra subsidies to offset inflation. When they reach the legal age of retirement, they will be shifted to newly created pension agencies that are administered by the local government. Before they become real pensioners, the early-retired workers would be on the payroll list of the company that remains obliged to pay their pensions. In exchange, the early-retired workers disclaim their rights to reemployment in the company. In other words, the company had to buy out superfluous employment positions at the cost of continuing to pay living expenses and pensions for the early-retired workers.

In comparison, the vacancy waiters were relatively young and physically strong (e.g. a youngest one aged 21 in the MW-1), they are expected and encouraged to take up paid-jobs elsewhere as a complementary source of income. Since they were assumed as laid off workers temporarily and are supposed to be re-employed by their company in the future, vacancy waiters (including women with newly-born children after expiration of the paid absence of two years) are therefore insufficiently compensated for leave (see Table 4).

It should be noted that all the laid off workers were not directly released to markets. Instead, they were all kept inside the company as required by the government due to the lack of social security system in society. Except for those who found jobs elsewhere after downsizing, most of the layoffs were absorbed into the company's internal labour pool and live on expenses paid by their company for at most two years[43]. As a condition for the receipt of living expenses, both types of layoffs are obliged to contact their employer once a month so that their company is informed whether there is change in their employment status.

In addition, vacancy waiters living on their company were required to register with the local Labour Bureau to obtain an officially endorsed unemployment card. With an unemployment card, layoffs are entitled to a priority for reemployment in the former company or elsewhere, or pursuing self-employment (Beijing Review, 1998). Moreover, all the layoffs living on company payments also need to pay for their individual parts of

[43]After two-year dole on the company, layoffs will be shifted out to unemployment insurance agencies administered by the local government.

the pension premium, unemployment insurance, and housing funds[44]. The company would keep on paying the remaining parts for them, i.e. a certain proportion to the total wage bill in the company set by the local government. Obviously, downsizing in the absence of social insurance support poses tremendous difficulties to management in executing the downsizing in the firm.

At first sight, downsizing seemingly proceeded more deeply in the MW-2 than in the MW-1 in terms of layoff scale and percentage. With a close look at the workforce composition after laying off, it is found that downsizing in the MW-2 failed to touch managerial employees as much as was the case in the MW-1. A higher proportion of managerial and administrative employees remained in the MW-2 than in the MW-1 after downsizing (see Table 7.5). In the MW-1, elderly managerial personnel were also subject to downsizing. It was stipulated that middle-level managers aged over 56 during downsizing were compulsorily left off their positions, either as non-managerial staff or as early-retired workers. Consequently, 150 elderly managerial and technical personnel were laid off, accounting for 15 per cent of the total layoffs in 1997. Among the sacked managerial personnel 50 middle managers took the form of early retirement. By so doing, downsizing on other types of personnel was perceived much easily to carry out with less resistance from workers.

Table 7.5. Post-downsizing workforce profiles in the MW-1 and the MW-2, in 1997

	MW-2		**MW-1**	
	Number	%	Number	%
Production workers	2,100	43.48	3,000	61.24
Technical staff	403	8.76	300	6.12
Managerial and administrative staff	1,002	21.78	405	8.26
Auxiliary workers	1,000	21.74	650	13.27
Marketing and service staff	395	4.24	544	11.20
Temporary workers*	110*	-	-	-
Total employees on duties	4,600	100.00	4,899	100.00

Note: *temporary workers were not counted on the payroll.

Clearly, the *once-and-for all* workforce reduction in both the firms reshape the profile of the remaining workforce after downsizing action. In the MW-1, almost all the elderly workers were laid off, with the remaining workforce becoming much younger (averaged at 35) than before downsizing. The same change also occurred in the MW-2, only with a slight age difference imposed on elderly employees between workers and managerial cadres[45]. While all the old workers aged 50 for the female and 55 for the male were called

[44] The proportion of individual payments to these funds was set at 3% of their monthly wage incomes received from their company in 1998.

[45] The differentiated treatments to early retirement can be explained by the legacy of old personnel system by which employees were divided into workers and cadres in line with the bureaucratic hierarchy (see Korzec, 1992).

for early leave, managerial cadres retired early at the age 55 for the female and 60 for the male. In consequence, the remaining workforces become much younger. As one of the interviewed personnel managers points out:

> "Right now, it is rare to find elderly male workers aged over 50 in our production plants, except for a few elderly key workers with critical skills. None of the female workers aged over 40 is working in the first line of the production. Young workers become the overwhelming majority".

In summary, the two state firms studied are operating under the increasing pressure of market competition within the changed context. They share similarities in governance and market declines while differing in employment and compensation. The main criteria used for the selection of layoffs were age and performance, supplemented by physical state and sex. Some other social and political criteria were applied as well to prevent specific groups from downsizing policy. There are some overlaps among these imposed criteria, with each one being related to others in some manners. Layoffs were most likely among those elderly workers with low skills and poor physical conditions. Yet, young employees were not exceptional if they were identified by management as the unskilled, and the undisciplined, or child rearing women during downsizing. In either case, laid off workers have a poor labour market prospect after downsizing. This can explain why most of the layoffs were kept in the company's internal labour market pool instead of releasing to markets, although both the firms had incentive to terminate labour relations with layoffs by strongly encouraging vacancy waiters, for instance, to find jobs elsewhere.

7.2.3 Effects and payoffs of downsizing

Besides quick workforce reduction, the two firms investigated receive immediate payoffs in labour productivity after downsizing. In particular, considerable changes have occurred in work organisation with respect to flexibility. Moreover, efforts of the top management to alter corporate internal structures have been partly achieved after downsizing. By referring to Cameron's (1994) downsizing framework outlined in the first part of the chapter, this section will examine these impacts in sequence.

7.2.3.1 Improved labour productivity

Improvement in labour productivity was achieved immediately after downsizing was executed in 1997. A salient upturn was registered in both the firms in terms of sales turnover and profits and taxes relative to the reduced workforce over 1996 and 1997 (see Table 7. 6). When assessed in terms of sales turnover per worker, the MW-2 saw a noticeable rise of 67 per cent, while the MW-1 received 40 per cent of increase over previous year.

Table 7.6. Labour productivity improvement after downsizing 1996-1997

	MW-1			MW-2		
	1996	1997	Change	1996	1997	Change
	(1)	(2)	(2) – (1)	(3)	(4)	(4) – (3)
Sales turnover (RMB million)	600	680	+80	101.06	104.42	+3.36
Profit and tax (RMN million)	25	30	+5	-19.53	-17.14	+2.39
Employees (in person)	6,100	4,899	-1,201	7,441	4,600	-2,841*

Note: * The number includes 608 newly retired workers living on external pensions administered by the local government.

The extent to which labour costs of production were reduced with mass layoffs, higher labour productivity could be a logical result. Empirical findings from the two cases confirm that the shrunk workforce after downsizing worked with the same number of machines generated more outputs than the past. Although labour productivity improvement measured by these two indicators is open to question, it is clear that efficiency gains were achieved in both the firms after downsizing. The interviewed managers in the two firms all acknowledged that downsizing was indispensable for efficiency improvement.

7.2.3.2 Increased flexibility in work organisation

With downsizing substantially reduced workforce, flexibility of the remaining employees is sought and achieved in the two firms investigated after downsizing. Currently, work is flexibly organised along the functional or numerical dimension, and employees are flexibly staffed to take job tasks on production need. In particular, laid off workers are occasionally re-employed as a personnel buffer against production fluctuations. Here, several forms of flexible working practices can be observed in the two downsizing firms (see Table 7. 7).

Table 7.7. Summary of flexible working practices achieved in the MW-1 and the MW-2 after downsizing, in 1997

Flexible working practices	**MW-1**	**MW-2**
Part time, over time working	+	+
Contingent labour	+	+
Teamwork	+	+
Job enlargement	+	+
Job rotation	+	+

" + " = present

- Part-time and overtime working

Although both the firms studied follow five working days per week as required by the Labour Law, part time and overtime working are under wide practice in response to

product market fluctuation after downsizing. Often, extra-working hours are required of the existing workers during a production peak, even though an expected extra payment is not ensued as expected. When production turns to a slump as the result of a drop in market demands, less working time (such as half a day working) applies, leading to less wage incomes than usually to employees. Sometimes, idle working time during the business slump period is spared to do cleaning or simple maintenance tasks (such as cleaning machines). This type of work is beyond the scope of the job description, and was undertaken by temporary workers in the past. Here, flexible-working arrangements are dictated by production requirements or market demands. It often goes together with flexible payments based on output-related performance.

> In the MW-2, an *interval work shift* is introduced to adjust personnel to work task fluctuations after downsizing. This form of flexible work arrangement is mainly practised at the workplaces such as in repair plants, and in assembling plants, where work tasks are contingent on unpredictable demands of clients. If work is performed by a team, whose members' performance is hardly metered individually and separately identified from others, an interval working shift applies among all team members on an equal footing to avoid further streamlining of redundant members. This kind of interval working shift takes turn every half a year or a season, thereby each team member taking a turn for rest and work. Essentially, the interval working-shift turns out to be a kind of part time working practice. It is indicative of more personnel remained than necessary in the workplace that should be laid off from an efficiency perspective.

- The internal labour pool as a personnel buffer

As indicated, laid off workers in both the firms were not immediately released to external labour markets[46] during downsizing. Instead, they were kept inside and administrated in an internal labour pool in the company's labour market. In the MW-2, 500 layoffs were registered with the company's personnel department and sunk in the internal labour market pool. Layoffs in the internal labour market pool are occasionally used as a personnel buffer working part time against production fluctuations. This has become possible because the downsizing company continues to provide basic living expenses to laid-off workers as long as they remain unemployed. In return, layoffs are obliged to offer temporary service to the company as a personnel buffer. The functioning of the internal labour market pool as personnel buffer should be assessed with caution. First, the set-up of internal labour pool was mainly to administer layoffs that could otherwise be released to the labour market in the presence of well-developed social security systems. Second, not all of the layoffs are willing to provide temporary personnel service for their company. Temporary workers are continuously hired from external labour markets (in the case of the MW-2) to undertake some unexpected tasks or dirty work that is unwillingly taken by layoffs.

[46] Layoffs from the company's collective plants are not entitled to entry into the internal labour pool since they were never counted as state employees by their employment status.

- Teamwork

Teamwork emerges in both the firms as some job tasks are shared horizontally across prescribed job boundaries after downsizing. Employees are strongly encouraged to take more responsibilities and work in co-operation with their colleagues in a team. To some extent, flexible work practices of this type can be ascribed to change in rewarding systems that embrace incentives for task sharing. Management in both the firms acknowledges that workers are willing to take more work tasks, because more work tasks imply higher income under the performance-related payment system.

- Job enlargement

Job enlargement is now experimented in certain categories of jobs after downsizing. In the MW-2, for instance, bench workers or fitters are encouraged to undertake a job of grinders, while in the MW-1, repair workers take the job of bench workers or fitters. Therefore, job descriptions are no longer narrowly defined as the demarcation line between job boundaries becomes increasingly blurred. A limitation on job enlargement is that most employees lack necessary skills to take up an upgraded job. Such skills require extra training that is often unavailable in the two firms studied[47] after downsizing. Another limitation on job enlargement is that most job enlargement arrangements are overwhelmingly restricted to immediate job-related components, without the empowerment of workers with respect to planning, maintenance, and quality control. Very often, managerial authority is still concentrated in the hands of the functional department management.

- Job rotation and internal mobility

Another significant change in work organisation is that employees are willing to undertake jobs across plants or departments. This job rotation across different functions become possible because most attractive job positions are now open to employees for competition based on their skills and past performance. For instance, 40 middle managers aged 50 were laid off from their managerial positions in the MW-1 in 1997 that were then open to competition for new staffing from within. Along with job rotation, there is a rise of internal labour mobility across functions and administrative hierarchy. For instance, in the MW-2, an excellent outperformed worker can be promoted to the plant's supervisor, and unqualified technical personnel are assigned a production job in plants. This represents a big stride in breaking job ownership that prevailed in work organisations. Most significantly, laid off managers in the MW-1 are willing to take up new jobs in production plants. Obviously, job rotations along a downward mobility across functional departments become acceptable in the downsized firms as long as it is required by production requirements.

In summary, functional and numerical flexibility is sought and, to some extent, achieved among the remaining employees after downsizing. Moreover, additional numerical flexibility is also explored among laid off workers that sunk into the company's internal labour market pool. As shown above, flexibility remains obviously primitive and, to some

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[47] The MW-1 plans to train 100 workers to enable them cope with versatility of multi-skills in five years after downsizing.

extent, is restricted by workers' insufficient skills. This points to the need of extra training for upgrading employees' skills.

7.2.3.3 Intensified work and tightened labour discipline

Along with flexibility at the workplace, work is intensified and labour control tightened. Three work-related results are achieved after downsizing, according to personnel managers interviewed in both the firms. These effects concern: shirking behaviour, labour discipline, and values regarding work.

First, the phenomenon of work shirking has considerably diminished, as the prevailed '*one job shared by three while no body taking responsibility'* was effectively eliminated by downsizing. Instead, each employee is given a separate assignment and responsible for the ultimate work results. Intensified work can in part be attributed to flexible compensation that links payments more directly to individuals' performance after downsizing. It is also partly ascribed to the threat of job-loss pressure suspending on the workers that elicit their commitment to work. The interviewed personnel manager seems very happy with this result, he said: "our employees are striving to compete for more work tasks from their colleagues. Since more work will bring them more bonus payments in a piece rate."

Second, a significant improvement is recorded in labour disciplines. As compared to the past, employee absenteeism almost disappeared immediately after downsizing. Instead, all the remaining employees are punctual, and the incidence of early leave without a prior notice has become the thing of the past. In particular, one's duty negligence caused by his arbitrary absence from the job during the working time is eliminated. As the threat of another round of downsizing is suspending, most of the remaining employees work under pressure. They recognise that their personal fates are closely linked to the prospect of the company. The personnel manager comments on this change:

> Our workers treasure and value their employment positions much more than ever before. They are often told that their employment opportunities were bought out at the expense of their colleagues who now remain unemployed. They know how costly unemployment would be if they had not worked hard. If there is no job task for employees, they will turn to learning additional skills that might be required some day in the company.

Third, some obvious changes have occurred in employees' work values with respect to differentiated rewarding and job choices. Wage differentials are acceptable among employees that reflect differences in individuals' performance. And workers are willing to perform different job tasks assigned to them, regardless of employment status associated with job tasks. Right now, the entire workforce is called employees, without a distinctive status divide between workers and cadres, which only remains visible in personal files[48].

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[48] Every Chinese adult has a personal file that records his/her history and administered by the state agencies.

Most noticeably, laid-off workers start to undertake some jobs that were left to temporary workers in the past. In the MW-1, temporary workers are no longer hired any more after downsizing. This is a contrast to the MW-2 where a hundred temporary workers are employed continuously. Another positive by-product of the downsizing is that most of the employees have stronger wishes for acquiring new skills either via training or by self-learning during spare time.

In short, downsizing enables management to experiment with various forms of flexible practice at the workplace. With flexibility sought by management, work becomes intensified and labour disciplines tightened. To a great extent, work redesign proposed by Cameron (1994) was achieved in the two state firms studied after downsizing.

7.2.3.4 Change in corporate structure and business orientation

Most significantly, downsizing led to restructuring of organizational structure in both the firms investigated. It is observed that the two downsizing firms either re-configured their corporate structure or re-oriented their business focus or scope, or a combination of the both. Behind the corporate restructuring is the penetration of market pressure into the entire company.

In the MW-1, the corporate organisation underwent drastic restructuring after downsizing. First, quasi-market price mechanisms were introduced into the corporate internal transactions so that all of the company's 13 subsidiaries should become financially accountable. Most remarkably, one of the 13 sub-corporations was split off to form a joint venture[49] with foreign investors immediately after downsizing in the early 1998. The joint venture was successfully created largely because: 1) the MW-1 had enjoyed an advantage of its products in environmental protection[50], and 2) it had a stock of advanced equipment and machine tools imported from Germany. By forming a joint venture with foreign investors, the MW-1 is entitled to receive preferential treatments of Sino-foreign joint venture policies (e.g. income tax rate levied on joint-venture is as half as that of on the SOE, i.e. 15 per cent as opposed to 33 per cent).

Second, each subsidiary has established a marketing department responsible for getting more market shares on competition. Accordingly, all internal activities are justified for accountability on the market ground. The parent company, i.e. the MW-1, no longer maintains a marketing department. Instead, a multi-functional management centre has been set up to co-ordinate internal and external transactions of subsidiaries. Subsequently, the remaining departments are accordingly required either to change their functions and orientations or had to be demolished. For instance, the technical and engineering department (staffed with three hundred employees) was enhanced in function by

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[49] Subsequently, the shares of the newly formed joint venture will be listed on Shenzhen Stock Exchange in B share (i.e. in foreign exchange) open to overseas investors.

[50] For instance, its industrial boilers could use sugar stalks as fuel materials, instead of coal. In addition, the products of the MW-1 were designed by Germany, Britain, and Japan and mainly supplied to growing domestic markets.

integrating R & D with quality control. Some of R & D activities were contracted out, or jointly undertaken with external experts invited as consultants. A personnel department and a financial management are centralised in the parent company, namely the MW-1.

Comparatively, the MW-2 failed to launch dramatic corporate restructuring as in the MW-1 during and after downsizing. With persistent losses incurred in operations, the MW-2 reoriented its business strategy toward focus as well as diversification (see Porter, 1985). A focus business strategy was reformulated with the aim of consolidating and refining the core business in machine manufacturing, while externalising auxiliary activities from the main body of the organisation. One noticeable stride with respect to diversification was to enter into the service sector for export and import trading. The move to diversification was based on the MW-2's autonomy over export and import granted by the central government since 1987. Such the autonomy over international trading is not common to the majority of manufacturing enterprises in China. With the rights to exports and imports, the MW-2 hopes to spur revenue growth through the access to international markets. Here, the diversification strategy is essentially built on deliberate management efforts to exploit the company's internal comparative strengths.

Accordingly, the corporate structure was redesigned: first, the core business was separated from the remaining, with the main body of the MW-2 concentrated on machinery manufacturing. Meanwhile, the auxiliary body that mainly comprises trading, plus service facilities (such as company-run kindergarten, employee hospital, canteens, bathing rooms, restaurant and hotels) were all split off and operated as semi-independent accounting entities. Then, all the personnel and staff were realigned with the changed corporate structure through job-skill matching and relocation based on internal competition for available positions. By doing so, the personnel size in each department was streamlined and internal personnel mobility prompted. Obviously, the mixed strategy combining business focus and diversification was pursued in order to avert risks of over concentration in one industry after downsizing. Such action should also be seen as management' attempts to reverse persistent operational losses of the company in the machinery industry.

Although differing degree of corporate change and orientation in the two firms studied, it is clearly that corporate restructuring was driven mainly by management's attempt to explore internal comparative strengths that each downsizing company possesses within constraints of business environments. One change common to the both firms is that market pressure has penetrated into the entire corporate organisation; another change is that the use of labour is increasingly flexible and linked to organisational efficiency. Nevertheless, expected systemic changes from bottom-up were not observed, especially with respect to the corporate culture.

7.3 Summary and discussion

The downsizing processes documented in the two firms investigated above clearly have some fundamental characteristics in common (see Table 7. 8).

First, both the firms belong to large-sized manufacturing firms in terms of employment by the Chinese standard. Second, they both were initially set up by the central government in the same city and about the same year in the 1950s. Thus, they operated for a relatively long period of time under the state planning system, and inherited identical institutional legacies from the past. Thirdly, they were both corporatized recently into joint stock firms and exposed to market forces. Yet, the state (or via its agencies) retains the right to dispose of the property while encouraging private actors (e.g. in the MW-1) to exercise the agency's rights as shareholders. Fourthly, both firms are currently operating under the increasing market pressure, and no longer enjoy the guaranteed sales channel to domestic clients regulated by state plans. With the state product quota system demolished in the 1990s, they had to seek orders facing competition. From 1992 onward, both the firms adjusted their excess production capacity to their shrinking market shares, and eventually stepped up to downsizing in 1997.

Table 7.8. Main characteristics of the MW-1 and the MW-2

	MW-1	**MW-2**
Age and location	1959, and Wuhan urban centre	1958, and Wuhan urban center
Ownership & governance	State-owned, and corporatized recently with participation of foreign investors	State-owned, and corporatized recently with state being a majority controller
Products	Industrial boilers of special types	Heavy machine tools, lathes of various sizes
Sales revenues (1997)	RMB 680 million yuan	RMB 104.42 million yuan
Profit and tax (1997)	RMB 30 million yuan	RMB -17.14 million yuan
Product markets	100 percent domestic, with market share of 15-16 %	Mainly domestic, with limited exports to the Middle and South Asia
Number of employees (1997)	6100 on the payroll, 4900 on working positions	7441 on the payroll, 4600 on jobs
Labour contract coverage	100 percent coverage, with varying duration	Without individual labour contracts except for a collective one
Employee income (on Average in 1997)	RMB 9600 yuan for employees on jobs	RMB 6000 yuan for employees on jobs, 3300 yuan on the payroll
Wage system and Compensation practices	Post, skill, service, bonus, plus subsidies	Post, skill, and service, without bonuses

Despite the similarities shared by the two studied firms, some salient differences stand out upon a close check.

First, the two firms studied had different employment systems during downsizing in 1997(see Table 7. 8). The MW-1 adopted a legally recognised *labour contract system* that covered 100 percent of the workforce, while the MW-2 implemented an employment-specific *labour agreement* that lacked a legal enforcement base when breach occurred. The difference in employment systems implies, as was shown above, different job security or freedom left for employees during downsizing. Although both the types of employment systems marks a departure from the lifetime employment, management's discretion over personnel recruitment and selection is impinged upon by continuity of the government administrative labour assignment. This points to internal inconsistency of HR practices arising in the two firms.

Second, the scale of remuneration differs markedly in the two investigated firms. Although both the firms adopt a similar post/skill wage system in which job position and individual skill carries main weights, the annual incomes per employee in the MW-2 was below two-thirds that of in the MW-1 in 1997(see Table 7. 8). The lower remuneration level in the MW-2 was attributed to the absence of bonus payments to employees, which was linked to persistent operational losses in the company. In contrast, higher remuneration levels allowed management in the MW-1 to implement internal wage differentials that could be high as RMB 1000 yuan between production workers and non- production workers. In the MW-2, wage differentials among employees were kept as low as possible because of the already lower remuneration on the whole. The top manager interviewed acknowledges that the average annual wage incomes remained unchanged since 1994. Therefore, real incomes of the MW-2 employees were on the decline if considering inflation during that period of time. Accordingly, noticeable difference exists in the compensation of layoffs between the two firms studied, as shown above. In general, layoffs were better compensated in the MW-1 than in the MW-2, just corresponding to the different wage incomes as rewarded to the remaining employees in both the firms. This was so because the downsizing firms had to compensate layoffs out of its own wage funds that were linked to the firm's performance. The compensation was particularly lower for vacancy waiters in the MW-2. As the personnel manager argues in the interview, "when workers on the job could not be rewarded sufficiently, let alone to ask for decent compensation to laid off workers."

Thirdly, although some changes occurred in corporate structures of the two firms studied during and after downsizing, the extent of changes penetrated into the two downsized firms unevenly and differently. While the MW-1 pursued an out-sourcing strategy by seeking a joint venture with foreign investors, the MW-2 adopted an in-ward perspective on exploring its internal comparative advantage by separating its core business from the remaining. In the former case, the entire corporate structure was reconfigured and realigned to some extent after downsizing. In the end there was an enhanced accountability among the subsidiaries, both financially and managerially. For the latter case, namely, the MW-2, the corporate structure was streamlined and de-coupled, with a complementary body split off the business core. There was no empirical evidence on changes at the level of functional departments.

Despite obvious achievements outlined above, downsizing failed to solve all the problems confronting the two firms studied. In particular, HR practices and policies applied to workers during and after downsizing have given rise to inconsistency of HR systems that reinforce existing problems in the two downsizing firms.

The most pronounced problem is that of adverse selection associated with the rising labour turnover of skilled workers during and after downsizing. In both the firms studied, the most mobile workers were found among the newly recruited employees who were either young technical personnel, or managerial staff. Comparatively, production workers and administrative staff remained stable. Since voluntary leavers tended to be among relatively skilled young employees with a high education attainment, there are certain rules and procedures that govern voluntary leavers [51] in both the firms before and during downsizing. For instance, not all the voluntary leavers were encouraged. Conversely, most of the voluntary leavers were often persuaded to stay with their firms if their skills and expertise is particularly needed in the organisation. Despite this, loss of skilled workers was on the rise. In the MW-2, for instance, the number of technical employees dropped from 1,100 in 1988 to 403 in 1997. The majority of technical employees left the company just before downsizing started. And most of them took voluntary leaves and found a higher paid job in the private sector. Here, downsizing served as a driving force that pushed away key talented employees out of the organisation. The loss of best people led to the shortage of technicians in the MW-2. This, in turn, severely affected its product quality and competitiveness.

The same brain drain problem is observed with the early retirement scheme. In particular, some old employees with specific skills are most likely more willing to retire early. There are two key reasons for unwanted leave: first, the income difference is not more than 25 per cent between those working and those without; second, there might exist attractive employment opportunities elsewhere for them to take up immediately after early retirement. By doing so, they increase their total monthly income. Thus, the lack of internal consistency in HR systems makes it difficult for the company to predict what types of employees will take advantage of an early retirement offer or buy-out package. Accordingly management is uncertain of what type of relevant knowledge, what organisational memory, and which critical skills will be lost to the organisation when employees leave. In other words, here management faces the problem of *adverse selection effects* due to inconsistency of HR systems in firms (Baron and Kreps, 1999).

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[51] Voluntary leavers have to pay their individual part for pension premium, and other compulsory funds set by the government. The type of voluntary leavers was called 'post reservation while stopping wage payment' by their previously employed organization. Some of the voluntary leavers maintained labour relations with their company in name and paid fees (individual pensions 3%, and housing funds, 5%) for their pensions and housing funds on their individual part. The company paid the remaining majority part (26 % for pensions, 5 % for housing funds). In practice, both the company and employees disclaimed employment obligations to each other. They were called 'Liang bu zhao" (i.e. employee and employer do not have an obligation to each other). However, the majority of redundant workers at that time stayed with the MW-2.

Along with the loss of talented employees is the declining capacity of the downsized firms to attract and recruit newly qualified employees from labour markets. This declining ability is particularly pronounced in the MW-2 because it cannot compete very well for talented personnel on the labour market, due to their lower wage level relative to the private firms. Both the downsized firms acknowledged a declining number of new entrants recently recruited from local universities. Drain of skilled employees, coupled with a declining number of new entrants, poses a threat to the survival of the firms under currently intensified competitive business environment. It also undermines the long prospect of the company's development. In order to cope with the shortage of skilled employees, the MW-2, for instance, had to rely on the company-run technical school to meet its technical personnel needs by lowering entry quality. This is inconsistent with the company's efforts to concentrate on the core business by cutting off social welfare activities.

Another problem, related to first one, is the declining commitment of the downsized firms to training investment. Frequently, the increasing drain of skilled labour, pushed by inconsistency in HR practices associated with rising labour turnover, encourages the downsized firms to withdraw, rather than to increase its training commitment that is a key to boosting businesses after downsizing. Lack of training opportunities, in turn, pushes more workers to leave the company. This self-enforcing circular process leads to critical acquisition and selection problems. In the two firms studied, both the internal (i.e. in-house) and the external training (i.e. contracted out to local universities) were cutting off for cost-savings after downsizing.

In addition, downsizing failed to change management behaviour. As indicated, downsizing was mainly targeted at elderly or poor performing young workers, to less extent to middle managerial personnel (in the case of the MW-2). It failed to affect the top management team members (including a general manager, Party secretary, and deputy managers) that were all appointed by the government supervisory agencies. Moreover, management performance was subjected only to annual appraisal conducted by the local municipal government's Organisation Department. From the views of personnel managers, and others interviewed, the top managers remain conservative, lacking the spirit of adventure and innovation after downsizing. In the eyes of personnel manager at one company investigated, top management tends to be more bureaucratic than entrepreneurial. He expressed:

> "As a result of downsizing, employees value their employment positions with high commitment and high morale. Management should take this opportunity to make a stride and explore new frontier of the business. However, our top management is engaged in routine tasks, cultivating good personal relations with the government supervising agency".

Inconsistency of HR systems is also reflected in top management team members. Frequently, internal attrition arises among top management. That is, top managers themselves do not always get well with each other because of the difference in their personality and leadership style. Essentially, they are agents of the state (i.e. the principal) with different, most likely conflicting, personal goals and desires that are not often in line

with the interest of the company, or vice versa. When conflicts occur, for instance, between the general manager and the Communist Party secretary, nobody may want to yield in and leave room for the other. Most likely then, they apparently stay together peacefully while struggling underground for the control of managerial power. As a strategy, both the general manager and the Party secretary keep silent, not reporting directly to their supervising agency while privately cultivating personal relations with government officials. They fear that any *formal* report about their coalition attrition might discredit their leadership capacity and personal reputation. What they are most likely to do is to adopt a 'wait-and-see' strategy, until the supervising agency discovers that a change of leader composition is indispensable. Under these circumstances, they put aside management tasks that may jeopardise the interest of the company. In the words of the personnel manager interviewed:

> What the top managers most wish to see is worsening of the company's situation. Its collapse or bankruptcy might provide them an opportunity for a new appointment in another comparable organisation at the same hierarchical level or above. What they most unwilling to see is the state of no vigour yet no death at sight in the company.

Clearly, the management appointment and appraisal by the government cannot fully solve the principal-agent impasse under the CMRS. Conversely, it provides a unique fertile soil on which the top managers can cultivate good personal relations with the government supervisory agencies during their term in order to secure a better bureaucratic position after the termination of their contract[52].

In summary, downsizing gives rise to the leakage of human capital from the two downsized firms. The loss of human capital resulted from both the growing labour turnover during (even before, i.e. *earlier movers*) downsizing and the declining capacity of the organisation to attract new skilled entrants from labour markets after downsizing. In addition, the downsized firms suffer from the increasing loss of organisational memory and competence that disrupts the continuous business process of the firms. On the other hand, downsizing failed to generate sufficient pressure on the top management for a sustainable efficiency gain commitment. Instead, top managers continue to engage in internal attrition for bureaucratic control or promotion, rather than concentrate more fully in daily management. In other words, top managers enjoy relatively secure bureaucratic positions, with a weak link to performance of the state firm under their responsibility.

7.4 Concluding remarks

In the transition to market economy, SOEs, as demonstrated by the two investigated machinery manufacturing state firms, encounter severe challenges of losing market shares and skilled personnel, due to the increasing competition on domestic markets. Downsizing is for the first time becoming a hammer wielded by management in China's SOEs as a

[52] One extreme example is that the general manager often invites local officials to tour abroad financed by the company.

means of reducing labour costs, improving efficiency and tightening labour discipline. Despite this, downsizing was mainly implemented as a defensive (cost-driven) reaction, rather than proactive (value-added) response to market share decline in the industry, with the government push and support.

The empirical findings can well be explained by Cameron's (1994) approach to downsizing. First and foremost, downsizing has substantially reduced the workforce over a very short period of time. Along with the workforce reduction is a quick upturn in profit revenues that were received by the two firms immediately after downsizing. Second, and most significantly, downsizing has led to work redesign to such an extent that flexible working practices are implemented among the remaining employees. Accompanying flexible working practices, work becomes intensified and strict labour discipline is imposed. Moreover, downsizing gives rise to changes in the corporate structure that were driven by business re-orientation during and after downsizing. However, the cross-board systemic changes from bottom-up are not observed in both the downsizing firms.

What distinguishes the downsizing process in China's state sector from the downsizing framework of Cameron's (1994), as well as from other transition economies, is that the move to downsizing in the two state firms studied was mainly driven by the government. Second, the state managers adopted the '*first-in and first-out*' downsizing strategy with elderly workers as the main target category. Thirdly, mass layoffs during downsizing were not directly released to markets. Instead, they were sunk into the company's internal labour pool and lived on the payment of their firms. It is clear that the practice of downsizing in the two state firms studied was shaped by two factors, the path-dependency of the past institutional legacies and market pressure of the ongoing changes in the business environment.

Despite the achievements in terms of headcount and work redesign as observed above, the two firms studied are still facing critical challenges. Externally, intensified competition forces state firms to lower cost, and quick respond to market changes, while the underdeveloped social infrastructures (such as unemployment insurance, and pensions), as well as the continuous government intervention in the personnel area, constrains managerial discretion in the adjustment of the workforce to fluctuations in markets.

Internally, most severe challenges come from inconsistency of HR systems in the two downsizing firms. As observed, the increasing labour turnover, coupled with the declining capability to retain and attract qualified personnel from external labour markets, led management to reduce its training commitment to employees. This would further push the best employees more and more away when they envisaged less and less promotion and training opportunities in the future. Here, training is obviously becoming an important rewarding component for employees. The availability of training functions as an effective means of attracting and retaining skilled employees, in addition to contribution to their flexibility and competence that is a source of the firm's competitive advantages.

All of these problems can be largely ascribed to the top management behaviour characterised by bureaucracy instead of entrepreneurship under the changed business environment. Downsizing did not impinge on vested interests of the top managers. Instead,

it might enhance top managers' bargaining power in their negotiation with the government supervisory agencies. Usually, top managers still take seriously directives from above, rather than concentrate on markets and employees' long-term well being. In this sense, downsizing provides an opportunity for managers in the state sector to exploit labour flexibility under the authoritarian management regime supported by the state.

From a broad institutional perspective, one might expect that by bringing market forces back in, downsizing breaks up the tale of tripartite-coalition of the government, management, and state workers that has been upheld as the state socialism so long symbolically. Downsizing in the first place marks a withdrawal of the government from the coalition. On the other hand, downsizing represents a new gesture of the government to reform SOEs by pushing state workers to markets. From the management perspective, downsizing is a double-edged knife: repressing labour for the cost-effectiveness while introducing antagonistic labour relations in the workplace. From the workers perspective, downsizing has profound implications beyond job insecurity in the state sector. It has rendered state workers disenchanted from the lifetime employment system in SOEs. Frequently, the unskilled, and elderly employees suffer most from downsizing, whose interests are lacking protection from the company-based unions. In particular, the expected role of trade unions acting as a countervailing force towards management is purposely curtailed by the state. On the other hand, downsizing triggers off labour mobility. As observed, young skilled workers tend to leave the downsizing firms to look for better jobs elsewhere, and their leaving pose a dilemma for the downsized organisations to catch up with their rivals.

Nevertheless, downsizing has posed challenges that are just emerging in society. Not only is such radical labour reform a culturally and politically sensitive area of management, but also the consequence of downsizing that has incurred mass layoffs and unemployment poses a threat to the government and leads traumas to workers. For the government, by pursuing labour market practices it marks a retreat from its past long-lasting commitment to the full employment policy guaranteed to all able workers. This perilous break-up from the orthodox ideology thus stirs up a political debate on the nature of labour, namely, the status of workers, in the socialist country that might further undermine government legitimacy. For ordinary workers, by introducing labour market policies into the enterprise it implies employment insecurity that threatens their stable jobs and incomes. It is not surprising that strong resistance to change arises when workers lose their jobs for the first time in their lives (Cheng, 1989). The resistance is most latent in SOEs, whose employees are most likely adversely affected and "whose major stakeholders are not always supportive of (and are sometimes outright hostile to) such reforms" (Shenkar, 1991: 1). This calls for more research on downsizing from the workers perspective.

Whatever challenges remain after downsizing, costs are critical for state firms to survive today's competition first, and then gain a competitive advantage for tomorrow in present China. A long-term prospect for SOEs to catch up their rivalries lies not only in cost effectiveness, but also resides in their organisational capacity to develop human capital, and more importantly, to retain it for a flexible utilisation. However, the growing drain of human capital revealed in our two downsized state firms has substantially undermined the long-term competitive advantage base of the firms. Downsizing, when executed in its

narrowest strategic vision and in absence of fundamental changes in the management style, cannot solve the persistent inefficiency problem facing SOEs.

Chapter Eight

CONCLUSIONS

Introduction

The preceding three chapters examined flexible working practices adopted at the workplace level, as related to the firm's HR system. This chapter is to arrive at conclusions by synthesizing the empirical findings revealed from the analysis. It should be noted here that, although this case study research investigated ten manufacturing firms chosen from the three industrial sectors with diversified forms of ownership, conclusions generated throughout this research might not be extended to firms operating in other industrial sectors, even in firms in other Chinese cities. This is mainly due to limitations of case study research itself as indicated in chapter 4. Moreover, the regulatory framework (including labour market conditions) in China differs considerably from city to city, and changes greatly over time. In other words, any attempts to generate conclusions from this study need to account for difference in time, space, and location.

8.1 Referring back to research questions

This empirical case study research aimed at shedding light on the workplace practices with respect to labour flexibility in ten selected manufacturing firms. The purpose of the research was to explore *how Chinese managers seek to increase labour flexibility in manufacturing companies in response to increasing market competition under the changing institutional framework in the transition economy.*

This central research question was broken down into three sub-questions:

Q1. What types of labour flexibility are sought and achieved at the workplace level?
Q2. To what extent has the company's HR system changed consistently to support workplace flexible practices?
Q3. What institutional constraints or opportunities confront management in the attempt to increase labour flexibility in the company?

In addressing the three specific sub-questions, ten manufacturing firms were selected from two different development regions (i.e. Shenzhen and Wuhan), covering three industrial sectors. Most of the investigated manufacturing firms are either knowledge intensive or capital intensive in nature, while they differ greatly in ownership, age, and management coalition. However, they all face intensifying competition from domestic and international rivalries. In order to survive market competition and to continue operating in a changing institutional framework, management adopts competitive strategies with different focuses (*cost-cut* or *value-added)* that distinguish state firms from non-state firms.

Most state firms studied focus on cost-effectiveness, downsizing, and internal restructuring (e.g. WM-2, WM-1, PhW-1, and PhW-2), while a few emphasize the value added strategy that seeks competitive advantages from human resources and functional flexibility (e.g. PhW-3, and PhS-5). Newly emerged private firms, in contrast, pro-act with both the cost-cut and value-added strategies, with an overwhelming focus on their core business (e.g. TeleS-2 and PhW-4), while seeking business diversification from related markets (e.g. PhS-6). A joint-venture firm (i.e. TeleW-1) and a newly created state firm (PhS-5) fall in between the two extremes, exhibiting characteristics of both old state firms and newly created private firms in response to market pressure. The competitive strategies adopted by management with different focuses are shaping and being shaped by the firm's HR system and labour flexibility practices.

8.2 Synthesizing the empirical findings

As indicated above, management's incentive to increase labour flexibility in the company stems from the growing demand for responsiveness of the workforce to market changes due to the changing business environment, as well as from management effort to avoid employment rigidity as prevailed in state firms. Two types of labour flexibility are mainly attempted among the firms in this study: *numerical* and *functional*, each with different forms.

It was observed that numerical flexible work practices (shift work, flexible working time, and the growing use of temps) were increasingly used and applied to production workers in all the firms studied. Moreover, management's attempts to initiate job quitting, layoff, and firing and dismissing distinguish between state firms and non-state firms in this study. The collective-based layoff policy, with the government support, was implemented in all the old state firms studied to get rid of redundant workers for cost effectiveness. In contrast, non-state firms tend to launch individually based radical labour adjustments by resorting to manipulated job quitting, or dismissing and firing.

This study has shown that labour flexibility, when sought along the numerical dimension, can immediately lead to cost reductions, thereby increasing labour productivity. The cost effectiveness consideration has become the overwhelming philosophy for the management of production workers in all the firms studied. Abundant supply of unskilled labour in China provides management with favorable labour market conditions for exploring numerical flexibility in the firm. Hence, management seeks numerical flexibility mainly among production workers who can easily be substituted from labour markets. These

employees are therefore treated as peripheral production workers, and given undue training for firm-specific skills. However, the lack of sufficient training for the firm-specific skills may harm labour productivity improvements in a long-run.

On the other hand, functional flexibility, as a value-added flexibility strategy, is mainly sought among the perceived core workers that consist of managerial employees and technicians in the companies studied. Top management expects the added value of technical and managerial employees largely because this core segment of the workforce is relatively rare in China. Hence, the core workers are often offered relatively long employment contracts through which various functional flexibility practices are attempted for both cost saving and value added purposes. However, it is hypothesized that the expected empowerment and delegation of managerial decisions associated with job enlargement and enrichment were not or limited realized at the workplace. On the contrary, there is an obvious trend of centralizing management in most firms studied. Despite the remaining hierarchical style of management, it is clear that Chinese managers have strong incentives to seek labour flexibility along both numerical and functional dimensions in manufacturing companies.

As revealed from this study and as assumed in the literature, flexible labour practice cannot be successfully implemented at the workplace without the supporting HR system in place. HR policies and practices must be internally consistent and fit with the firm's external environment. This research shown that firms that adopt both cost-cut and value added flexibility strategies have either transformed old HR systems inherited from the past, or established a new system. In firms that have established consistent HR systems, management can explore potentials of labour flexibility, without or with little damage to commitment of employees under flexible employment relationships (TeleS-2, PhW-4, PhS-5, and TeleW-1). Conversely, firms with partially consistent HR systems or conflicting HRM that feature corporatized state firms (WM-2, WM-1, PhW-1, and PhW-2) encounter enormous dilemmas as management attempts to revamp the past HR systems, and increase labour flexibility at the workplace. The most announced dilemma relating HR consistency in state firms is that management has to keep talented employees for a long-term commitment while maintaining flexibility of the workforce. As a result, inconsistency in HR systems arises most likely in old state firms where part of HR systems has been transformed into market practices while the remaining is still locked in the past personnel systems. Inconsistency is rooted in the legacy of the past personnel practices (i.e. labour and managerial personnel assignment, and state wage guidance) that still work under the transition economy. Legacy is even manifested from conflicting HR practices and policies as observed evidently in a newly created joint venture (i.e. TeleW-1), with the presence of state ownership, and in newly created state firm (i.e. PhS-5).

Local labour market conditions clearly cast impacts on the firm in adopting labour flexibility practices and appropriate HR system. Firms situated in the costal special economic zone Shenzhen are more market-oriented to HR policies and practices than firms in an inland city Wuhan, due to different legal and policy environments designated by the central government (see chapter 4). Firms in Shenzhen face stricter labour regulations than their counterparts in Wuhan in the time of recruitment of temps and migrant labour from the local labour market. Despite this, firms in Shenzhen are enjoying relatively loose

labour market supply, and adopt more flexible work practices than firms in Wuhan, if taken the same industry for comparison. Given the more flexible working practices and more market-oriented HR polices adopted at the workplace, state firms in Shenzhen (e.g. PhS-5) look more like private firms in Wuhan. In other words, newly created state firms in Shenzehn have less resemblance of state socialism even if they are in state ownership.

Hence, most flexible firms are private firms. State firms remain inflexible despite departing from employment rigidity. A cross industry comparison indicates that two non-state telecom firms are most flexible organizations in the growing telecom industry facing intense competition. At the opposite end of the flexible spectrum are two state machinery firms that remain inflexible in a declining machinery industry. Within the pharmaceutical industrial sector, the same pattern is observed: flexible private firms and inflexible state firms competing with each other for market shares. Among all the firms studied, a general trend can be observed that: old state firms attempt to move toward flexibility, but they still suffer low adaptability. The low adaptability of older state firms is mainly due to their relatively old workers employed and bureaucratic management style associated with institutional legacies from state socialism.

Apparently, managerial discretion to explore labour flexibility at the workplace varies considerably between the firms that find themselves in a wider process of deinstitutionalization and reinstitutionalization associated with the transition economy in China. Frequently, state managers are subject to more institutional constraints (i.e. the state wage guidance, labour assignment, and management appointment) than private managers in developing market-based consistent HR systems to facilitate their efforts for higher labour flexibility at the workplace. As observed, state firms that show 'half-way' transformation meet with constraints of inconsistency in HR systems as management attempts to adopt flexible labour practices at the workplace. This is so partly because the required re-institutionalization is not yet in place, or falls behind the transformation of state firms in market competition. As a result, labour flexibility achieved so far is unevenly penetrated across industries and among firms within the industry, as well as across the regions.

The institutional legacies are clearly reflected in the state firm's internal governance and management style over time. In a typical reformed state firm, the dominant coalition is comprised of Party secretary and general managers who are appointed as agents acting on behalf of the state for a certain period of time (usually three to five years). Their composition, as well as their norms, and values they share with each other, have profound implications for the management of human resources. With the recent corporatization program, power balance of the dominant coalition in state firms has shifted from the Party Secretary to the general manager, or leads to integration of the two different positions into one, held by the general manager. As a result, internal attrition is eliminated to a great extent between the Party secretary and the general manager. Despite the enhanced managerial authority in SOEs, top state managers' career development largely relies upon bureaucratic promotion rather than entrepreneurial success in the turbulent business world. Reflected in the management style is that state managers tend to actively respond to expectations of supervising agencies, while leaving daily management as second priority. Comparatively, the non-state firms are confronted with less constraint than SOEs, and

therefore the top management in private firms exhibits more entrepreneurship and less bureaucratic style.

Besides the top management team, enterprise-based *trade unions* and *workers congresses* are supposed to play an important legitimate role in defending workers interests vis-à-vis management in state firms, according to laws. However, the prescribed roles of both trade unions and workers' congresses in most state firms studied are weakened, with the overwhelming management authority over workers in work organization. In particular, the status of workers' congress is considerably weakened vis-à-vis the newly emerged board of directors, and its monitoring role is replaced by the shareholders congress after the corporatization of state firms in the 1990s. The enterprise-based trade union, although widely present in all the state firms studied, is actually subordinate to management authority. This is so because the trade union chairman is also appointed by the local government in consultation with the top manager in state firms. In other words, it is impossible to expect any strong stance of the trade union on behalf of workers in interaction to top managers in state firms. As this research revealed, the union chairman does not have much say over HRM practices, except for the moment of representing employees in signing a collective labour contract with the general managers. The submissive position of the trade union chairman derives essentially from the conflicting roles assigned to the trade unions in state firms: i.e. representation of workers' interest, meanwhile assisting top managers in the management of labour.

Interestingly, while the role of *Communist party organizations* in the state firms studied is increasingly restricted to the non-managerial activities (such as monitoring and ensuring the government policy to be implemented), all the private firms studied have voluntarily established a *Party Office* for the communist membership employees in their organizations. The presence of Party Office in private firms is actually advocated by top managers intentionally for '*business convenience*', without any pressure from the local government. Conversely, trade unions, which are required by Law, are not all present in the private firms studied. In particular, workers' congress, which exists in all the state firms studied, is absent in the private firms studied. However, the Party Office and trade unions (if any) in private firms do not constitute dominant coalition components in top management teams. Like its counterparts in state firms, the Communist party organizations and trade unions in private firms are less likely to act as the countervailing forces against management authority. Frequently, a supportive role is expected of Party Office and trade unions in private firms to aid managers in the management of workers. Another important role is to create an external channel through which a constant contact with relevant external government agencies can be maintained purposely.

Obviously, the creation of Party Office and/or trade unions in private firms is beneficial to managers to minimize adverse effects in the unpredictable business environment. It can at least bring three types of benefits to top managers in private firms: 1) to build up an image of legitimacy in society, 2) to gain an official recognition from the local government, 3) to get rid of predatory harassment from arbitrary external supervising officials. In other words, establishing Communist Party Office, and to less extent, trade unions, in private firms is a strategic choice that the top managers attempt to obtain what is needed and what is to avoid under a transition context.

The managerial strategic "*buffering and bridging"* can be partly ascribed to management's reaction to the powerful isomorphic processes of the institutional coercion and mimicry on its constituent firms. To a great extent, top managers in both state and non-state firms are vulnerable to the unpredictable external business environment in which Communist Party Organizations are at the center. Yet, the top management's reaction to challenges and uncertainty posed by the external environment differs remarkably between private firms and state firms. Private firms usually seek to buffer externally adverse institutional shocks by symbolically establishing government appreciated political offices inside their organizations, whereas state firms' managers resort to individual opportunistic behaviour by cultivating personal relations with external supervising officials at the cost of the organizational efficiency gain. By all accounts, the dominant coalition with entrepreneurship in private firms is most likely to pursue flexible work practices in organizations.

Given the evolving institutional framework in China, management's strategic choice in the area of HRM under the changing internal and external constraints does matter to the firm's performance. This empirical analysis clearly shows both a pro-active and a re-active aspect of management's strategic choice in respect to organizational decision-making vis-à-vis environment. It is observed that state managers enjoy increasingly autonomy, while the growing autonomy of state managers in some aspects is still restricted by external government supervising agencies. Like their counterparts in private firms, state managers can take external initiatives, including the choice to enter and exit businesses. They can also make adaptive internal arrangements, e.g. crafting HR policies and practices. At the same time, the institutional environment sets limit to the scope of action by imposing constraints on managers performing at their will. Since China's emerging institutions are becoming open to flexible interpretations, state managers find themselves in a position of having to respond to feedback from the environment if their organizations are not to risk severe market and institutional penalties. This feedback, in turn, provides firms' managers with a learning opportunity to minimize transaction costs in the changing business environment.

The dynamics of interactions are significant from the perspective of transaction costs in the area of HRM, such as those between managers and employees, between organizational agents and their supervising institutions, and in effect, between choice and constraint. As the empirical findings clearly shown, management's effort to increase labour flexibility practices is subject to different constraints or opportunities. Often, state managers face more stringent regulatory constraints than their counterparts in private firms when seeking labour flexibility from the workforce. However, state firm managers sometimes seek rents of the institutional legacies by take advantage of state ownership to minimize transaction costs (e.g. contracting out of R & D activities to state research institutions). In contrast, private firms have to survive market competition and have little chance to obtain bureaucratic supports. Despite this, private firms managers tend to mimic the behavior pattern of their counterparts in state firms through cultivating good personal relationships with government officials meanwhile exploring better conditions for their firms' operations.

From the resource dependence perspective, increasing market transactions in China' state sector have to a great extent reduced the dependency of state-firm managers on the central government for the supply of critical resources at subsidized prices. One method for reducing dependence, as shown in the research, is to internalize external parties by seeking good relationships with influential people who are formally outside the organization. As a result, business firms and their external supervising agencies are becoming inter-penetrated through collaboration between key actors with the aim to protect their core activities from adverse external influence. The distinction between 'firm' and 'market', and between 'market' and 'bureaucracy' is thus considerably blurred, as management is actively involved in '*buffering'* and '*bridging'* environmental adverse impacts. Accordingly, with the declining external dependency upon bureaucracy for allocation of critical resources, all the firms studied need to compete on markets for securing and retaining their required resources, including human resources.

8.3 Conclusions

To conclude, the business firm in China's transition toward a market economy has increasingly reassumed a role as an economic entity of the West sense, in producing goods or services for profits, providing employment, and generating tax revenues to the state. The success of the firm lies not only in cheap labour, more importantly it resides in highly skilled and motivated human resources that are flexibly employed. In order to survive and continue operating in the increasingly competitive business world, Chinese managers tend to seek numerical flexibility from production workers (i.e. the peripheral workers, or the low skilled labour pool) who exhibit high substitutability due to excess supply of unskilled labour in China. Here, firms and managers in order to maintain labour adjustment need freedom to find ways of smoothly hiring and firing unskilled labour, using short-term contracts, offering less training, and differentiating wage rates contingent on markets. On the other hand, functional flexibility is mainly attempted and sought from managerial and technical employees (i.e. the core workers, or the skilled labour pool) whose skills are relatively rare in China. Here, the management needs to find effective ways of retaining smart people while seeking their value-added flexibility, by developing schemes of career prospect, offering training, tenure, bonus, and stock options. Eventually, the various forms of labour flexibility practices adopted and applied to different segments of the workforce reflect management's strategic considerations in aligning transaction costs of labour that differ in skills and performance to meet fluctuations of production to changing market demands. In other words, labour is not a fixed cost as was the case in former SOEs. Labour has become an important source of maintaining a competitive advantage to the firm's success when it is flexibly employed and efficiently utilized.

The observed two flexibility strategies are simultaneously implemented within the same organization while applied to different segments of the workforce. Essentially the two contracting flexibility strategies represent two employment strategies of *cost-cut* and *value-added* that management has actually pursued in the organization. These strategies, in their turn, are largely dictated by the two corresponding competitive strategies (*cost-focus* or *value-focus*) that the firm chooses to gain a competitive edge in a specific industrial sector.

However, the extent to which labour flexibility has been achieved at the workplace relies largely upon the firm's supporting HR system that has changed toward market practices with internal consistency. Changes of the firm's HR policies and practices are subject to product market competition, and local labour market conditions. The firm's HR policies and practices are eventually subject to the external political institutional environment that manifests itself through the firm's ownership, age, and internal core coalition. By and large, private firms, as well as newly established joint ventures with foreign investment, take a lead in adopting labour flexibility at the workplace, supported by consistent HR system at the company level. State firms, by contrast, lag behind due to various constraints in adapting to markets or transforming HR systems in a consistent manner. In this sense, 'reinvention' of HR systems in state firms may have a long way to go.

8.4 Further research areas

In the future study of Chinese firms' HRM in general and work organization in particular a few areas deserve more attention. First, well-developed concepts and tools in the Western literature may not be applicable to China without necessary modifications, given different local cultural/political/social/legal conditions. In particular, workplace flexible practices are subject to the firm's HR system that is linked to external institutions. For instance, there is a debate on the application of HRM concept to personnel management in China. It is observed that HRM in most of China's firms has 'Chinese characteristics' (Warner, 1993). The same is true in applying the concept and forms of labour flexibility in China.

Second, more attention should be given to workplace practices and their rationale. As revealed in this research, labour flexibility adopted at the workplace takes different forms and applies to different segments of the workforce that is not very divergent from practices in the West. However, Chinese managers tend to differentiate workers according to their skills, positions, education attainments, and legal residence registration. These employment-related attributes influence workers' employability in labour markets, as well as the way they are treated in the company. Hence, different flexible practices applied to workers may reflect management strategic consideration in aligning labour costs with the value-added contribution of the employee to the success of the firm.

Third, management's effort to pursue labour flexibility may pose challenges to employment stability and employees' commitment. The observed numerical flexible practices (e.g. frequent hiring and firing of peripheral employees, laying-off, and the increasing use of temporary workers) have contributed to high labour turnover. As a consequence, the process of organization learning is severely hampered, and firm-specific knowledge and skills may get lost. The continuous business operation may constantly be disrupted by the rising turnover of labour associated with management's pursuit of flexibility. Hence, it can be assumed that success of the firm in China's emerging market economy will be highly dependent on management's capability to attract and retain the core motivated staff who are skilled and exhibit long-term commitment. Thus, more attention should be drawn to the issue of how to keep highly qualified workers while exploring flexibility of workers, which could be another area for the future study of HRM in Chinese firms, probably related to the regional wage rate differentials. As the transition

towards a market economy proceeds, it is more likely that the company can profit no longer from the abundant supply of cheap labour. In other words, the company's long-term prospect lies in the development of highly skilled, and flexible, human resources in the organization.

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Appendix I: List of Abbreviations

ACFTU	:	All-China Federations of Trade Unions
CMRS	:	Contract Management Responsibility System
FDI	:	Foreign direct investment
GDP	:	Gross domestic products
GMP	:	Good Manufacturing Practices (in pharmaceuticals)
HR	:	Human resources
HRM	:	Human resource management
LLCs	:	Limited liability companies
LLSCs	:	Limited liability shareholding companies
MPT	:	Ministry of Posts and Telecommunication
RMB	:	Renminbi (Chinese currency, 1US$ = 8.09 RMB ¥, in 1998)
SEZs	:	Special Economic Zones
SFJVs	:	Sino-foreign joint ventures
SSEZ	:	Shenzhen Special Economic Zone
SOEs	:	State-owned enterprises
TVEs	:	Township and village enterprises
VAT	:	Value-added tax
WMB	:	Wuhan Machinery Bureau

Appendix II: Case Description of the Ten Manufacturing Firms Investigated

Case study no.1: PhW-1

The contemporary PhW-1 originated from a small pharmaceutical manufacturing plant that was set up in 1939 by a Communist-led army against Japanese invasion during World War II. It finally settled in Wuhan in 1953 four years after the foundation of PRC. From then onward until 1993, PhW-1 had been a state owned factory under the supervision of the local Medical Administrative Bureau affiliated with the Wuhan municipal government. In 1994, the Pharmaceutical Factory was corporatized into a joint stock company, with the state controlling 90 per cent shares of the total asset. The remaining shares were sold out to the employees based on seniority.

By corporatization, three new authority pillars (i.e. a Board of Directors, a Board of Monitors, and a shareholders congress) have been established and co-exist with other three old power pillars in the company (i.e. the communist party committee, workers congress, trade unions). The chairman of the Board of Directors himself takes a position of the general manager, who has autonomy in appointing middle managers without securing a support from the above or the company communist party secretary. One of the four deputy general managers holds the post of communist party secretary. They are assistants to the general manager and all appointed by the Board, and endorsed by the government. In this way of corporatization, two parallel internal authorities (i.e. managerial director and communist party secretary) prevailed in the past have been unified, with a general manager enjoying autonomy inside the organization. Corporatization has also brought about change in relation to its external supervising agencies. The company is now reporting and accountable to the Wuhan State Asset Management Company. This is a newly created state asset agency taking a seat on the Board of Directors to govern operations of the state, and appoint top management (including the company's communist party secretary). But key personnel appointments must be reported to the local Communist Party Committee for an ultimate approval, albeit in a less direct way.

PhW-1 has three production plants, employing 3,100 workers (in 1997). The core business of the company is manufacturing and selling of western generic pharmaceutical ingredients and medicines. The annual turnover of sales was over RMB 300 million yuan in 1997, of which the export revenue was over US$ 10 million. Profit and tax amounted to RMB 44.5 million yuan. The product markets cover all over China and of which some are sold abroad to 20 countries.

Case study no 1: PhW-1. Summary

1. Age and location	1953, Wuhan
2. Ownership and governance	State owned, and corporatized recently
3. Products	Various pharmaceutical ingredients and preparations
4. Sales (1997)	RMB 300 million yuan
5. Profit + tax (1997)	RMB 44.5 million yuan
6. Product market coverage	Mainly domestic (almost covering all the country), limited exports
7. Mode of production and applied technology	Line production, team work, and un/semi-skilled and skilled manual work; Routine technologies with semi-automation and semi-mechanization
8. Number of employees (1997)	3100 (in person)
9. Employee annual income (1997)	RMB 6,300 yuan

Cast study no 2: PhW-2

The PhW-2 is a pharmaceutical conglomerate originated from a public-private joint venture that was set up in Wuhan in 1953 and, shortly became a state-owned enterprise in 1955. From then onward to 1993, the Factory had been a state-owned pharmaceutical under the administration of Wuhan Medical Administrative Bureau, administrative agency affiliated with the local municipal Government. In 1993, it was corporatized into a joint stock company with the state holding majority shares of 74 percent while other corporate enterprises and incumbent employees jointly held the remaining 24 percent of total equities.

Corporatization has brought about changes in the company's internal governance, as well as its external relationships with the local government supervising agencies. Internally, a unified managerial authority was created in the company, namely, the Board of Directors, the Board of Monitors, and the shareholders congress by laws. The corporate governance replaced previously prevailed two parallel managerial authority lines (namely managerial director and communist party secretary) in the company. In particular, the powerful party secretary is now delegated as an assistant to the general manager, and focusing on non-managerial affairs in the company. The general manager, and deputy managers and chairman of trade unions comprise a top management team. They all sign a responsibility contract with the local State Asset Management Company on behalf of the local government.

The core business of PhW-2 is producing Chinese medicines of 14 types, 24 key products, employed 900 workers in 1997. One of the key products is '*Bone-enhanced powder of oyster*' protected by the state as a designed medicine used by children. Annual turnover of medical sales amounted to RMB 300 million yuan, with profits and tax of RMB 54 million

yuan in 1997. These products are mainly sold on domestic markets, with a small amount of exports to South-east Asia and Japan.

Case study no 2: PhW-2. Summary

1. Age and location	1953, Wuhan urban area
2. Ownership and governance	State-owned, recently corporatized into a joint stock company
3. Products	Chinese medicines of various types, mainly for children and babies.
4. Sales (1997)	RMB 300 million yuan
5. Profit and tax (1997)	RMB 54 million yuan
6. Product markets	Mainly domestic markets covering the entire home country, with a limited export to South-East Asia and Japan.
7. Mode of production and applied technology	Line production, manual hand working; routine tech. and labour intensive tech.
8. Number of employees (1997)	900 (in person)
9. Employee annual income (1997)	RMB 9,000 yuan (on average)

Case study no. 3: PhW-3

The PhW-3 originated from a family business that was set up in 1560 during China's ancient Ming Dynasty. It was named of the founder who invented a very effective ointment recipe for eye remedy. Four years after the foundation of PRC, this family firm was transformed into a public-private joint venture in 1953, and then nationalized into a state-owned enterprise in 1964. Like other state-owned firms, the PhW-3 came under the administration of local government Medical Administrative Bureau for 30 years. By 1995 it was corporatized into a joint stock company, of which a state-controlled real estate company from the Shenzhen Special Economic Zone, took the majority of 51 per cent of shares. The remaining shares were held by the local Wuhan State Asset Management Company (33 %), and by the company's individual employees (16 %) out of their own voluntary wills. Change into the corporate governance spurred the PhW-3 for a rapid growth that in turn brings several honors to the company. PhW-3 becomes one of the 500 largest pharmaceutical enterprises in China. It is honored as *China's Time-Honored Brand* by the Ministry of Internal Trade of the PRC, given its history of over four centuries. In addition, it is rated as an "AAA Enterprise" by the local credit assessment agency, and awarded a status of "Hi-New Tech Enterprise.

Similar to other corporatized companies, the PhW-3 is now falling under the administration of the local Wuhan State Asset Management Company. This holding company takes a seat on the Board of Directors. Another majority holding company -- the Shenzhen Baoan Corporation -- takes the chairman of the Board due to its majority holding

position. The general manager is now appointed by the Board, of which the local State Asset Management Company exerts proportionally influences on key personnel appointments. However, these two state holding firms are under the jurisdictions of different local governments, whose stakes in the corporation can effectively prevent one party from taking advantages of another. These also leave room for management to make decisions independent of governments.

By corporation, the Board of Directors exercises rights to appoint the general manager who is responsible for day-to-day management of the company and accountable to the shareholders congress. The authority of the general manager is further enhanced through taking the position of the Party secretary, i.e. two powerful positions held by one person, instead of by someone else in parallel. Despite this, the local government can still exert arm-length influences, via the local State Asset Management Company, on the company's strategic decision-making processes. In addition, the key personnel appointments must be reported to the local government agencies for a final endorsement on record.

The PhW-3 is located in the Wuhan East Lake High Technology Zone, with an occupied area of 96,000 square meters. It owns a multiple function office building of 6500 square meters in accordance with the GMP standard. The main competitive advantage of PhW-3 derives mainly from a series of the branded products linked to traditional Chinese ointment medicines, using the secret recipe of Ma's family. The annual sale turnover arrived at 80.2 million yuan in 1997, with employees of 800 on the payroll. The tax and profit reached 30.2 million yuan in 1997, rose from 23.9 million yuan in 1996. The rise of both the indicators suggests a good prospect for rapid growth over the past two year. The majority of the products are traditional Chinese medicines that maintain a strong competitive position in domestic product markets. These products are sold all over the country and some products exported to Asia, Europe, and North America.

Case study no. 3: PhW-3. Summary

1. Age and location	1852, Wuhan
2. Ownership and governance	Joint-stock company, with the state-holding majority
3. Products	Traditional Chinese medicines: ointments, plaster, oral liquid, and some western medicines
4. Sales (1997)	RMB 80.2 million yuan
5. Profits and tax (1997)	RMB 30.2 million yuan
6. Product market coverage	Mainly domestic markets, and some exports to overseas Chinese in Southeast Asia, Europe, and America
7. Mode of production and applied technology	Mixture of line production and hand working; Imported highly automated assembly line, plus routine mechanic technologies, and labour intensive
8. Number of employees (1997)	800 (in person)
9. Employee annual income (1997)	RMB 7,100 yuan

Case study 4: PhW-4

The PhW-4 is a private pharmaceutical firm that was founded in 1994 by six local university professors. It is located in the Wuhan East Lake High Technology Zone, the suburb of Wuhan. With the initial capital of RMB 506,000 yuan for the setup, these individual professors knew nothing about pharmaceutical manufacturing except for a high growth potential of high tech firms in China. They came together and selected an investment project in the pharmaceutical industry on the cure of Iron-deficiency anemia (IDA), a commonly occurring disease nation wide. At the very beginning, PhW-4 did not start with building up its own production plants that might be costly and time consuming. Instead, the company started by renting idle production capacity from local state pharmaceuticals to produce a new medical product that has proven a best selling nation wide. With profits accumulated from the sales revenues, PhW-4 gradually built up its own production capacity and facilities.

The company is a private pharmaceutical firm. It was established in accordance with the company law, with each participant partner contributing a certain amount of capital and bearing the proportionate risks. There was no direct government involvement in the setup, except for normal procedures for a business registration and license application to the government supervising agencies. Internally, RHK has a Board of Directors, namely initiators of professors, experts, and patent inventors. All strategic decisions are made at the Board of Directors that bears residual risks of business operations. Under the Board is a general manager who takes the overall responsibility for the daily management of the company, and who, in effect holds a position of chairman of the Board. In this sense, managerial decision making processes are highly centralized, although there are eight deputy managers seating on the Board as top management members. There are enormous overlaps in personnel composition between the Board and the top management.

Despite the pure private corporation by ownership, the PhW-4 has a party committee and a trade union organization in the company. Like SOEs, these two sub-organizations are conceived as complementary rather than contradictory to the functioning of management. Unlike other state firms, the PhW-4 owns a patent over the extraction of ferroproto porphyrin and enjoys a whole set of processing technology. The annual growth rate of sales turnover has been as high as 300 percent since the setup in 1994. Sales turnover reached 150 million yuan in 1997, with profit and tax revenues of 450 million yuan. The PhW-4 employed regular workers of 980 in 1997, of which 400 were managerial and administrative personnel working in the headquarters office. The remaining 580 were production workers staffed in two production plants. In addition, around 15,000 Salesmen were hired on a temporary base. Over 99 percent of the sales revenues were generated mainly from domestic markets, especially from the rural market segments. With a non-conventional manner of expansion at a fission wise speed, PhW-4 becomes one of the 15 top key industrial groups situated in Wuhan. It is rated officially as one of the 22 most fast growing enterprises in the local industrial sector. Currently, the PhW-4 invests a huge sum in building up a first-class pharmaceutical manufacturing plant in Wuhan East Lake New-Tech Development Zone.

Case study no. 4: PhW-4. Summary

1. Age and location	1994, and urban Wuhan
2. Ownership and governance	Private, corporation
3. Products	Oral liquid for Ferroporphyrin
4. Sales (1997)	RMB 1500 million yuan
5. Profit and tax (1997)	RMB 460 million yuan
6. Product markets	100 per cent of domestic (mainly rural market segments), attempt to explore international markets
7. Mode of production and applied technology	Line production, routine tech.; rent production plants; team groups in raw material processing
8. Number of employees (1997)	980 (in person)
9. Employee annual income (1997)	RMB 20,000 yuan

Case study no. 5: PhS-5

The PhS-5 is a joint stock pharmaceutical company located in the Shenzhen Special Economic Zone (SSEZ). It was jointly founded by 76 inland middle- and large-sized state-owned pharmaceutical enterprises under the auspice of the State Medical Administrative Bureau in 1983. The primary goal of the establishment was to open up a window in the SSEZ for inland state pharmaceuticals to gain an access to international markets in company with the 'open-door policy'.

From the outset of its establishment, the company adopted a corporate governance structure that differed from other state-owned enterprise in inland China. Although initial investment capital was pooled together from different state-owned pharmaceutical enterprises, each investor could not directly dispose the corporate asset separately at the cost of others. Instead, all individual corporate investors took a seat on the Board of Directors. Under the Board, the State Medial Administrative Bureau held the chairman position although the Bureau did not have a stalk in the form of capital investment. This was justified by the fact that all the corporate investors were under the State Medical Administrative Bureau in the bureaucratic hierarchy. And the general manager has been appointed by the State Bureau, and acts as a legal representative of the company responsible for business operations.

The PhS-5 initially focused on manufacturing and selling pharmaceutical and other related products. It extended its business scope from the end of 1980s to non-pharmaceutical sectors, mainly real estate development, textile and clothing, hotel, and building management. The core business of the company remains in pharmaceutical manufacturing and trading. The company has two joint ventures with foreign investors from the US and Japan that are located outside SSEZ and produce western medicines. However, the two joint ventures operated unsuccessfully due to bleak market prospects for the products manufactured in China. Hence, the manufacturing factory in SSEZ has become the backbone of the company in the pharmaceutical business that employed 500 workers and staffs on the payroll in 1997. This factory produces a variety of medicines, Chinese and

western. As such it was chosen as a main target of the investigation in this research. Annual sales turnover of pharmaceutical products amounted to RMB 100 million, with profit and tax of RMB 6 million yuan in 1997, accounting for 50 percent of the total turnover and 60 per cent of the total profit and tax in the company. The second largest turnover in the company's revenue incomes derived from building management and hotel that reached 20 million yuan in 1997. The company is authorized to conduct exports and imports. As a result, profits and taxes generated from the pharmaceutical trading (mainly imports) arrived at RMB 4 million in 1997.

Case study no 5: PhS-5. Summary

1. Age and location	1983, Shenzhen
2. Ownership and governance	Corporation jointed created by state firms
3. Products	Medical tablets and capsules
4. Sales (1997)	RMB 260 million yuan
5. Profit and tax (1997)	RMB 10 million yuna
6. Product market coverage	Mainly domestic markets
7. Mode of production & applied technology	Line production, with routine technology
8. Number of employees (1997)	500 (in person)
9. Employee annual income (1997)	RMB 36,000 yuan

Case study no. 6: PhS-6

The PhS-6 is a private pharmaceutical firm, founded by two youths (now chairmen of the board and general manager) in Shenzhen Special Economic Zone (SSEZ) in late 1989. It was originally registered as a Sino-foreign joint venture, with an Australian investor as a foreign partner. The first medical product that the company brought to markets was King Oyster that was based on a recipe bought out from Japanese. From then onwards, PhS-6 concentrated on the pharmaceutical & bio-technological engineering as its core business. From the mid-1990s, the PhS-6 expanded its business scope to real estate, food processing, and other tertiary industries. Yet, the core business remains in pharmaceutical manufacturing (three manufacturing firms), and trading (a pharmacy trading company). In 1997, the fixed asset of the PhS-6 amounted to RMB 200 million yuan, with total employees of 488 on its regular payroll at headquarter. It was listed among the 300 key industrial enterprises with a priority to gain government supports chosen by the State Economic and Trade Committee and People's Bank, the central bank of China.

In terms of ownership, the PhS-6 is a private pharmaceutical company funded by private individuals Chinese or foreigners. Although foreign investment accounted for a negligible part of the total assets, the PhS-6 enjoys the preferential policy of joint ventures on tax holidays and exemption (the company does not want to expose details about the initial proportional composition of equity for the establishment). In the words of a deputy manager, the company is a private corporation, with employees as its main shareholders.

Employees hold the company's shares on the basis of their service length (i.e. seniority) and their positions. No body knows how much shares his colleagues have held since stock options are linked to individuals' performance and positions in the company.

Internally, the company has a Board of Directors, shareholders congress, and the top management team. The majority of shareholders are employees of the company, while the so-called corporate shareholders are foreigners from Australia and Hong Kong. There is no the state-owned stakes in the company. Hence, the state and the local government do not have any says over the operations and decisions of the company. In business, the company must accept inspection and directives of the local Medical Administrative Bureau and Sanitary Bureau. However, the company has communist party committee and trade union organizations. The party committee functions mainly as an intermediary between party member employees and above government supervising agencies. It does not assume any managerial part in the company's daily management. While trade union is set up as required by the local Labour Bureau to represent the interests of employees in the company. In practice, the main role of the union played is to act as a representative of employees to sign a collective labour contract with the company.

This green field firm experienced rapid development since its establishment at an unconventional high growth rate. Annual sales revenues jumped from RMB 2.07 million yuan in 1990 to 603 million yuan in 1997, of which the sales of pharmaceutical account for the majority. By 1997, sales turnover of the medical products rose to RMB 381 million, accounting for 63.54 per cent of the total turnover. The PhS-6 has established its own sales systems and product distribution channels around the country. There are 40 sales offices set up in different domestic market segments, with 200 sales subsidiaries and 1000 of salesmen employed. Through the sales system, the PhS-6 ensures its own medical products to be delivered to customers in time. Currently, all the medical products are sold on domestic markets, with a very few amount of exports to Japan and South-East Asia.

Case study no 6: PhS-6. Summary

1. Age and location	1989, Shenzhen
2. Ownership and governance	Purely private corporation with no state stakes in the company; highly centralized decision making authority
3. Products	Western and Chinese medicines using biochemical and bioengineering tech.
4. Sales (1997)	RMB 600 million yuan
5. Profit and tax (1997)	RMB 85 million yuan
6. Product markets	Mainly domestic markets with its own sales system and distriubition channels covering the entire country
7. Mode of production and applied technology	Line production, plus group production, with a high level of automation and mechanization; Sophisticated technologies varying from computer-aided automation to routine manual labour intensive tech.
8. Number of employees (1997)	488 (in person)
9. Employee annual income	RMB 36,000 yuan, in 1997

Case study no. 7: MW-1

The contemporary MW-1 was founded by the central government in Wuhan in 1956. It was one of the largest state-owned boiler manufacturers that were able to make various types of special industrial boilers. In 1994, it was transformed into a quasi-standardised corporation. Four years after the corporation, namely in early 1998, one of the company's thirteen subsidiaries was split off to form a joint stock company with a mixed partner, consisting of foreign investors from Hong Kong and France, as well as of seven domestic financial investment companies. The total fixed asset of the MW-1 was valued at RMB 800 million in 1997, of which RMB 300 million was transformed into equities of the newly established joint venture. Because of the establishment of the Sino-foreign joint venture, the entire MW-1 is entitled to enjoy preferential tax policies applicable only to foreign investors. While the corporate governance structure is supposed to apply to the newly formed joint venture in light of the *company law,* the rest of the company maintains the old governance structure as it had in the past.

By corporatization, a new internal governance structure is to be established in the newly formed joint venture in light of the *company law*. The company as a whole is still under the administration of the local Machinery Bureau. Top management team consists of the general manager co-held the party secretary position, seven deputy managers, and trade union chairman. The trade union chairman and party secretary share the same managerial privileges as of the general manager. They are appointed by the local Communist Party's Organization that is responsible for the appraisal and selection of communist cadres into state enterprises. As compared to other corporatized state enterprise, top management in the company does not have rights to appointment of middle managerial personnel. Since the company is a large state-owned enterprise by the Chinese official standard, it is ranked as an equivalent administrative level as high as a provincial government sub-division status in the bureaucratic hierarchy. The general manager enjoys bureaucratic treatment corresponding to that of local officials on the same hierarchical level.

The company has 13 production plants situated in the same area of Wuhan urban centre, employed 6100 workers on the payroll in 1997. The value of output amounted to RMB 600 million yuan in 1997. The sales turnover reached RMB 680 million yuan in 1997, with profits and tax of RMB 30 million yuan. The MW-1 had a market share of 15-16 percent in 1997 that was ranked the fourth in the term of sales turnover, after other three domestic manufacturers.

Case study no. 7: MW-1. Summary

1. Age and location	1959, Wuhan urban centre
2. Ownership and governance	State-owned, corporatized very recently with foreign investors participation
3. Products	Various industrial boilers of special types
4. Sales (1997)	RMB 680 million yuan
5. Profit and tax (1997)	RMB 30 million yuan
6. Product markets	100 percent domestic, with market share of 15-16 %
7. Mode of production and applied technology	Line production, functional production, with work teams, routine manual work; sophisticated tech with automation and mechanisation, plus routine tech with labour extensive
8. Number of employees (1997)	6100 on the payroll, actual working employees 4900
9. Employee annual income (1997)	RMB 9600 yuan on average

Case study no. 8: MW-2

The WM-2 was established in Wuhan in 1958 with the assistance of the former Soviet Unions. It had since been the largest state owned heavy machine tool manufacturer in China under the administration of the local Machinery Bureau of Hubei and Wuhan. It did not change its ownership and governance structure until very recently in 1996 when it was restructured into a corporation. Essentially, it remains in the state ownership, without much change in the diversification of state property rights into non-state shareholders after the corporatization.

By corporatization, the general manager is becoming a sole legal representative of the company. However, there is a party committee in the company that consist of 13 members led by the party secretary in parallel with the general manager in sharing management authority. Unlike other corporatized state firms, the general manager has no rights to appoint six deputy managers. Moreover, the company's Party secretary remains powerful over the general manager. Top management team consists of the general manager, party secretary, and six deputy managers. They are subject to annual appraisal of the local government, and appointed by the municipal governor, i.e. major. In business, the company accepts directives from the Wuhan Machinery Bureau (WMB) under the leadership of the local municipal government. Since WM had been red in operations over the past five years, reversing the trend of loss-making is a priority task of top management under the management responsibility system. Thus, the general manager has signed a reducing losses and making profits management responsibility contract with WMB.

Like the WM-1, the company is located in the urban center of Wuhan. Until the early 1990s, the company had been enjoying great privileges of being the largest state key firms in heavy machinery industry. From 1992, the company turned out to be operating in the

red as the result of the withdrawal of the state protection and guaranteed sales channels. The loss in operation became further severe as the machinery market was opened to imported goods in 1995. The core business of the WM-2 is manufacturing and providing mother machine tools of various types for other sectors, such as machinery, mining, metallurgy, transportation, natural resource extraction, and aerospace sectors. With 7441 employees on the payroll in 1997, the sales turnover reached RMB104.42 million while profit and tax turned out to be negative of 17.14 million. Because of continuing losses over the past five years, reversing the trend of loss-making from further worsening becomes a primary goal of management specified under the Contract Management Responsibility System. Thus, the general manager has signed a management responsibility contract with the local administrative authority Wuhan Machinery Bureau (WMB) in which reducing losses and making profits was the central content.

Case study no. 8: MW-2. Summary

1. Age and location	1958, and urban Wuhan
2. Ownership and governance	State owned, and mgt appointment by govt.
3. Products	Heavy machine tools, lathes of various sizes
4. Sales (1997)	104.42 million
5. Profit and tax (1997)	-17.14 million in red
6. Product markets	Mainly domestic, with exports to the Middle and South Asia
7. Mode of production and applied technology	Mixed mode of production with capital intensive tech.: Line production (in component processing plants) with a high level of mechanization, and modest automation; group production (in assembling and repair plants), with a modest mechanization and high level of automation; as well as routine tech., and manual work with labor intensive tech.
8. Number of employees (1997)	7441 on the payroll, 4600 on jobs
9. Employee annual income (1997)	RMB 3300 yuan on the payroll; 6000 yuan on jobs

Case study no.9: TeleW-1

The TeleW-1 is a Sino-foreign equity joint venture that was set up in 1988. It is located in the Wuhan New Technology Development Zone, within the reach of local universities' concentration. It is one of the few hi-tech joint ventures in the field of telecommunication manufacturing in China. Initial agreement for the establishment was reached in 1987 between two domestic partners (i.e. the Ministry of Posts and Telecommunication (MPT) and Wuhan Municipal Government), and one foreign partner. The starting investment capital of US$ 15 million was funded half to half by the Chinese partner and the foreign partner, respectively. The length of the equity joint venture was set for 20 years' time. During the period of the joint venture, the foreign partner is obliged to provide the latest technology to the company. In 1993, the initial foreign partner retreated from the joint

venture and transferred 37.5 percent of its held equity to another foreign partner. The Chinese partner bought additional 12.5 percent of equity during the transformation and thus became a majority holder up to 62.5 of the total equity.

As a joint venture, the TeleW-1 adopted a system of the general manager responsibility under the Board of Directors from the very beginning of its establishment. The Board of Directors was made up of eight directors, half from the Chinese side and half from the foreign side. The general manager takes the overall responsibility for daily management of business in the company, and reports to the board. The candidates for the general manager come from the both sides of the partners, with each side taking a general manager position for every four years in turn. The government agencies at the local and central levels take a seat on the Board through which supervision is exercised. But government supervising agencies would not directly intervene in daily operations of the company.

Since the establishment, the TeleW-1 has expanded very quickly in terms of both production capacity and size. It owns two production plants that specialize in the manufacturing of cables and optical fibers respectively. The main products are optical fibers (SM, MM, and dispersion-shifted types) and cables (direct burial, aerial, duct, river-crossing, flame-retardant, unitary tube, and other types at requests of clients), and components that are widely used in telecommunication, posts, aerial space, satellite, and other related fields. Annual turnover of sales of both cables and optical fibers reached RMB 880 million in 1997, with exports amounted to US $ 30 million. It has become one of the largest cable and optical fiber providers in China with high quality at competitive prices. Optical cables of various types are mainly supplied to meet domestic market demands, with a domestic market share of 20 percent in 1997, while exports of optical fibers accounted for 12 per cent of the world market share in 1997. The TeleW-1 had the total employees were 398 on the payroll in 1997, of which 160 were production workers, accounted for 40 per cent, the remaining are technical employees (130), 35 per cent, managerial and administrative staff (60) 15 per cent, temporary (44) 10 per cent. Employees are relatively younger, averaged at 30 in 1997.

Case study no 9: TeleW-1. Summary

1. Age and location	1988, Suburban Wuhan
2. Ownership and governance	Sino-foreign joint venture corporation
3. Products	Optical fiber, and cables
4. Sales (1997)	RMB 880 million yuan
5. Profit and tax (1997)	90 million yuan
6. Product markets	Mainly domestic markets, with exports of US$ 30 million a year (27 %)
7. Mode of production and applied technology	Line production, plus group production, team work; computer-aided automation, microelectronic processing technologies
8. Number of Employees (1997)	398 (in person)
9. Employee annual income (1997)	RMB 96,000 yuan (10 times higher than the local average)

Case study no. 10: TeleS-2

The TeleS-2 was set up by a retired army man in 1988, and located in the Shekou Industrial Area of the Shenzhen Special Economic Zone (SSEZ). Since then it has become one of the largest high-tech telecom equipment makers that combines research and development, manufacturing, and marketing telecommunication networks in China's fast growing telecommunication industry. Started by the sales of telecom components in local markets by six young engineers in 1988 headed by a retired army man, new product development and production quickly became its forte. By 1997, the sales turnover of telecom equipment rose 4.1 billion yuan, with employees of 5600 (mainly young graduates).

In terms of ownership, the company describes itself as a 'non-governmental high-tech corporation, collectively owned by its employees'. In effect, it is a private firm in which owners and managers are unified under a modern corporate governance business system. The founder holds both the position of general manager and the chairman of the Board. Internally, there is a Board of Directors that is made up of initiators at the time of establishment. The top management team consists of the corporate acting committee, top management committee, and functional divisions. Distinguished from most Chinese firms, state or non-state, The TeleS-2 has no trade unions, workers' congress in the company. However, there is a party committee in the company that bears no managerial function. The main role of the party committee is to serves as a transmission belt through which key government and party documents and policy papers could be reached the company. In addition, many employees are Party members who have a right to organize the committee according to the communist party constitution. Since no government agencies participated in the establishment, there are no state stakes in the company. The company enjoys high autonomy over its business decisions and operations. However, high ranked officials at both the local and central government levels cherish a great support for the business development of the company. The company is perceived as a model and symbol of China's national industrial rejuvenation in the high tech industry. Top state leaders frequently visited the company that brought a strong backbone to the company' business.

The TeleS-2 has achieved a great success in competition with at least 16 multinational firms on China's fast growing telecom markets (The Economists June 27th 1998: 79). Its products cover the entire domestic markets with a steady increase in market shares. This momentum for a strong growth will continue in years to come. In 1997, the sales of exchange networks hit telephone lines of 4.11 million, with the market share of 20. It also won 70 per cent of market for "broadband access networks" in the same year. In addition, the sales of ETS reached 127 sets, with the market share of 72 percent. Other key products such as 112ACD, tele-battery, STP, and SDH have a market share of 20 to 59 per cent by 1997. The company owns a number of the entire intellectual property rights or patents on the telecom products that were independently invented by its highly qualified professional employees. Every year it invests 10 per cent of annual turnover revenues in R & D, with the full participation of 40 per cent of the professional employees. This huge investment in R & D, combined with a large number of highly qualified young engineers' commitment, guarantees the company to keep the same pace of the world technological advancement in the telecom sector.

Case study no 10: TeleS-2. Summary

1. Age and location	1988, Shenzhen
2. Ownership and governance	Private corporation without the state stakes
3. Products	Telecom equipment
4. Sales (1997)	RMB 4,100 million yuan
5. Profit and tax (1997)	RMB 190 million yuan (tax)
6. Product markets	Mainly domestic markets, with exports to Russia, Middle East, South East, Africa.
7. Mode of production and applied technology	PC-aided production station, craft groups, line production with a high level of automation and mechanization; non-routine technology, latest processing tech. Imported from abroad..
8. Number of employees (1997)	5600 (in person)
10. Employee annual income (1997)	RMB 120,000 yuan (on average)

Appendix III: Interview Protocol

I. GENERAL INFORMATION

1. In which year the company was established, and by who?

2. Original ownership of the company and its change over time?

3. With which level of the government or its agency is the company registered and accountable for? What is the company's administrative rank?

4. How many workers were employed in 1997, as compared in 1996?

5. What was the company's annual turnover and profits in terms of RMB or products in 1996, and 1997?

II. QUESTIONS (questions asked during the interview in the company, with a focus on events in 1997 versus 1996)

1. Product market (concerning products and services provided)

a. Does your enterprise mainly manufacture standard products, that is, very simple mass products, or is the emphasis more on one-time products, that is, customer-tailored goods?

- standard products
- customer-tailored goods (or services)

b. How many products does your enterprise manufacture? Can you make a division of the products supplied, and orders or activities executed?

- complementary /substitute products or services
- consisting of similar components and /or activities / consisting of completely different components and /or activities

c. Who are your customers /buyers or groups of customers/buyer?

- internal clients
- external clients

d. Have changes occurred or can they be expected concerning the products supplied? If so, what changes?

- change in quantity and /or sales volume (quantitatively) of products
- change in kind of product (qualitatively), in connection with product demands of internal and external clients, and so on.
- generation of substitute products or completely new products

e. How does your enterprise anticipate these changes?

- several steering measures (list)
- quality of steering measures
- speed of introducing these measures

f. Is the uniqueness of your products related to delivery time or quality, or it is normally the price that is decisive?

- delivery time
- quality
- price

g. Are these changes to be expected with respect to the groups of clients/buyers and their demands? If so, are these changes far-reaching or not (intensity) and how often do they occur (frequency)?

- far-reaching/not far-reaching (quick and frequent fluctuations in size of the products to be supplied)
- often/ sometimes (short life cycle of the products)
- predictable /not predictable (quickly varying demands of internal and external clients)

h. Is it possible to predict the changes with regard to the products supplied? If not, what information is lacking?

- kind of change
- extent of change
- time of occurrence

2. Product market competition

a. What product market segments (PMCs) can be distinguished?

- spreading / concentration
- not related /related
- phase of the life cycle

b. Is there certain interdependence between these markets?

- related /not related
- strengthening each other /weakening each other

c. What position does your enterprise take in the relative market(s) (i.e. market share)?

- practically unthreatened position
- rather competitive and /or critical environment
- vitally threatened position

d. What marketing strategy does the enterprise take?

- sell products on geographically diversified markets
- sell products in non-related markets
- sell products in markets in different phase of the life cycle
- reduce the barriers against leaving PMCs already penetrated (lowering exit barriers)
- reduce the barriers against entering PMCs not yet penetrated by developing additional expertise or lowering the standard cost price (lowering entry barriers)
- bring new products to existing markets

- bring new products to new markets

e. What distribution channels does the enterprise have?

- with own distribution channels / entering existing channels of others
- concentration in local markets / national / international

f. Are the entry and exit barriers of these distribution channels large or small?
g. Who are competitors of your enterprise in PMCs?
h. Are there changes to be expected in the existing market segments? If so, what changes?

- generation of new markets
- collapse of existing markets

i. To what extent do these changes occur (intensity)? How often do they occur (frequency)?

- intensity
- frequency

j. Are the exit barriers of existing market segments high or low?
k. Are the entry barriers of new potential markets high or low (in terms of capital, increase in scales, distribution channels, product name)?
l. Are there new potential competitors expected?

- quick and regular entering and leaving of competitors
- predictable / not predictable

m. Do you have sufficient information about your competitors (assortment, and so on)? If not, what information is lacking?

- kind of competition (price, quality, delivery time, after-sales service)
- extent of competition (strength and weakness analysis of the market)
- time of occurrence (quick and cheap registration of the wishes of customers)

3. Production system (machinery, equipment, and devices needed to process and assemble subcomponents and basic materials into end-products)

a. Does the enterprise implement a modular construction, that is , a standardisation of part and equipment, but also a variety of end-products as a result of configuration change?

- normalisation of the preparation route
- normalisation of parts and materials
- preservation of scale advantage
- short delivery time (just-in-time)
- smaller stock of components
- purchasing advantage (just-in-time purchase)

b. Is there possibility of switching production system over to another line /machine workstation (shunt flexibility)?
c. Is there possibility of changing the machinery sequence (machine-routing flexibility)?
d. Is there possibility of changing the sequence of operations within a fixed machinery arrangement (product-routing flexibility)?
e. Does the enterprise increase the usability / applicability of existing machinery and equipment (multipurpose machinery)?

f. Does the enterprise use computer-controlled, adjustable machinery; numerically controlled machinery (NC) or robotization?

- broad usability
- low set-up costs
- possibility of changing the processing run (programming flexibility)

g. Does the enterprise apply CAD / CAM (computer-aided design / computer-aided manufacturing)?

- CAD
- CAM

h. Does the enterprise increase the mutual interchangeability of parts and devices?

I. Is quality measurement (i.e. QM) in the early state of the production process?

- early stage (emphasis on direct quality control, doing thins correctly the first time)
- middle stage (shift intermediate stocks to the final stage, sharpening quickness of reaction)
- end stage
- throughout

j. Are there priority rules and high-priority procedures?

k. How does the production process take place in the enterprise?

- unit production
- small batch prod.
- large batch prod.
- mass prod.
- process prod.

l. Does the supply of raw materials /input usually have little variation or is the range of variation very large?

- little variation
- hardly variation
- some variation
- large variation
- complete variation

m. Does the enterprise produce simple products with simple, fixed operations or does it concern tailor-made products with specific operations and a large variation?

- simple products / fixed operations
- tailor-made products / specific and variable operations

n. Does the enterprise manufacture varying batch sizes or are the production batches constant?

- varying size
- constant size

o. What cost factors determine this consideration?

- fixed costs (sunk costs)
- economies of scale and learning effects

p. Is the enterprise able to vary the production capacity at short notice?

- quantitatively (sales volume)
- qualitatively (composition of the volume)

4. Technology and application

a. Are there changes to be expected concerning the technology / expertise of the enterprise? If so, what changes?

- new technology
- innovation of process / product
- substitution technologies

b. Are these technological changes profound?

- far-reaching / not far-reaching (in the sense that it would adversely affect competitiveness of product without use of such tech.)
- regular / irregular
- fast / slow

c. Does the enterprise have sufficient insight into and information about any new technologies to be applied (i.e. predictable / not predictable)? If not, what information is lacking?

- kind of technological change
- extent of change
- time of occurrence

d. Where does the applied core technology come from?

- buying in markets
- making through R & D on the own
- using the tactics of the tech. follower (imitation)
- developing in collaboration with other organisations / competitors

e. What does the physical layout of process technology look like, that is, does the production process have a functional, group, line, fixed-position, or workstation layout (set-up of machinery, equipment, and people)?

- *functional layout*: grouping of activities which show similarities in methods and / or equipment; process arrangement
- *group layout*: grouping of activities as to product group so that each working cell thus originated produces a certain family group
- *line layout*: operations and machines are successively lined up in sequence
- *fixed-position layout*: the product to be manufactured remains in the same place, and the production equipment to be used is taken to the product
- *one workstation*: one person undertaking all activities for a certain product

f. How do you assess the extent of changeability of the layout design and configuration?

- have parallel production flows
- possibility of switching over to another line / station / machine (shunt flexibility)
- possibility of changing the sequence of machinery (machine-routing flexibility)
- possibility of changing the sequence of operations (product-routing flexibility)

g. To what extent do the operations depend on each other?

h. To what extent is the capacity of production utilised?

- < 50 %

- 50 % - 80 %
- 80 - 95%
- > 95%

i. Does the organisation frequently use inventories? If so, where are these found in the production process?

j. How large is the degree of freedom allowed by equipment? Can it produce different, related products?

- universal
- multipurpose equipment
- specialised equipment

k. To what extent are the machines switchable? that is, what are the costs and how much set-up time is involved in modifying the machines?

- many
- few set-ups required

l. Do individual employees use various production methods, techniques, or skills?

- limited /...../...../...../extensive

5. External labour market conditions

a. Does the enterprise have internal labour markets, that is, entry barriers to the enterprise is relatively high & strict selective, with entry only restricted to some jobs at the lower end of career ladder?

b. What is the position of your enterprise in the labour market, that is, is the enterprise attractive to people wishing to get permanent jobs and personnel?

- almost trouble-free recruitment of a sufficient number and quality of staff
- possibilities for permanent jobs rather limited
- quantitatively / qualitatively very restricted for permanent jobs

c. How much learning time (schooling, education, and training) is required to be able to undertake the work?

- interchangeability of personnel
- horizontal job enlargement
- vertical job enrichment

d. Does the enterprise use temporary personnel? If so, in what form?

- temporary employees
- employees on call
- seasonal employees
- contract to perform some service
- others

e. What makes up fixed labour costs in the enterprise?

- basic wages (by laws)
- pensions
- housing
- health care
- others

f. What is the relationship between fixed and variable labour costs? Can changes be observed in that relationship from the enterprise compensation practices (or systems)?

- observable / not observable
- variable labour costs in terms of:

6. Institutional environment and constraints

a. Does the enterprise have to deal with specific government stipulations and statutory restrictions? If so, what are they?

- size of investment
- use of new technology
- production (franchising, monopoly, sheltered, competition)
- product market coverage (local, national, international)
- appointment of staff of high status levels
- recruitment and selection of employees at different skill levels
- working hours
- minimum wages
- labour contract
- temporary employees
- pension schemes
- trade unions
- presence of Chinese Communist Party (CCP)
- others

b. To what extent can management determine on the following items within the regulatory policy environment? □unchangeable; □hardly changeable; □changeable; □rather changeable; □very changeable

• size of investment
• use of new technology
• production (franchising, monopoly, sheltered, competition)
• product market coverage (local, national, international)
• appointment of staff of high status levels
• recruitment and selection of employees at different skill levels
• working hours
• minimum wages
• labour contract
• temporary employees
• pension schemes
• trade unions
• presence of Chinese Communist Party (CCP)
• others

c. What institutional constraints do you face when management attempts to alter the established personnel policies on above HRM activities for the purpose of gaining flexibility, commitment, and quality?

- legal restrictions; such as minimum wages; labour laws; etc.;
- government regulations and policies on *labour and personnel* management systems, wage systems, income taxes, labour contracts, etc.;
- industry level constraints on tech., product market, working conditions
- property rights, i.e. ownership of enterprise;
- authority structure of the enterprise, i.e. professional management vis-a vis Communist party committee;
- presence of trade unions;
- workers congress representatives
- work rules, norms and customs

d. Of the above constraints mentioned, which can be negotiated and even overcome under conditions of the changing institutional framework? What costs or risks (economic, social, political) are involved when to managers take actions to bring in change?

7. Organization of work

a. Can you characterise the organisational structure based on grouping / departmentalisation? Or in what way are individual positions, units, and so on clustered within your organisation unit?

- by function
- by product or service
- by target group
- by place

b. Are there many or few hierarchical levels?

- hierarchical /…../…../…../flat organisation

c. How large is the size of middle management in relation to the top management?

d. Is there a strict separation between line and staff, or do they overlap in function?

- staff has the right to advise, line invokes the veto
- distinction between staff and line is blurred

e. Is the line management divides into various aspects of management?

- line / line-staff / functional / project / matrix
- unity of command / functional features / functionalization

f. Is there some kind of division of labour / specialisation in the enterprise which can be found in detailed job description and task descriptions?

- no /…./…./…./ very systematically

g. Is this division of work related to the number of activities that have to be carried out on the work floor?

- horizontal specialisation of work / horizontal job enlargement

h. Is this division of work related to the separation between the performance of activities and the control or administration of these activities?

- vertical specialisation of work / vertical extension of responsibilities (job enrichment)

I. Is there any divide of the workforce (core-periphery) in the enterprise which is defined by:

- number of different elementary operations per employee or station in terms of:
  small /…../…../…../ large
  simple /…../…../…../ complex
- technical steering and span of control of employees or stations along the production process
  small /…./…../ …../ large

j. Do employees (core or periphery; or managerial, technical, office, production worker) easily switch in practice from one job to another?

- never /…./…./…../ very often and easily

k. Does the management make use of:

- standardisation of the work process, that is, the degree to which contents of the work are specified and programmed
- standardisation of output, that is, the degree to which results of the work, such as products or performance are specified

l. Under what circumstances does the company make use of temporary workers or personnel outsourcing?

- Personnel buffer
- Production peak
- Complementary tasks
- Temporary work
- Specialists
- Specialized firms or institutions

m. How are temporary workers recruited and contracted?

- employment contract for a certain period or a certain job
- on call contract
- contract with vacation workers
- contract to perform some services
- freelance contract
- temporary employees
- outworkers
- trainee contract
- articles of apprenticeship / employment contract

n. Under what circumstances does management attempt to use following flexible working practices, and apply these practice to which segments of the workforce?

- Overtime work
- Part-time work
- Work shift
- Variable working time
- Lay offs
- Dismissing
- Job-sharing

- Short-term contract
- Flexible contract
- Labour pools
- Job rotation (work in different functional areas)
- Team work
- Work in multi-tasks
- Job enlargement (horizontal extension of responsibility)
- Job enrichment (vertical extension of responsibility)

o. To what extent has behaviour formalization put down in written work instructions, general rules, and job descriptions?

p. How does the decision-making take place in the enterprise?

- centralised /…../…../…../ decentralised (vertical)

q. Is there much consultation among functional departments, production units?

- liaison / project team / work team (horizontal decentralisation)

r. Can you mention an important crisis (or event) recently encountered by the enterprise to which employees responded strongly?

- downsizing (collectively)
- dismissals (individually)
- unanticipated promotion
- highly rewarding technical innovation or new product development
- training opportunities
- sales declining
- others

s. How do you characterise the leadership style of management in the enterprise? Suppose the leadership consists of a combination of directing and collaborating behaviour.

For directing behaviour (task-oriented / instructive):

- emphasis on task performance
- one-way communication
- control

For collaborating behaviour (relation-oriented / participative):

- emphasis on the mutual relationship (reciprocity)
- two-way communication
- employee involvement in decision-making

Four types of leadership style can be summarised as follows:

- mainly directing (task-oriented / instructive): indicating step by step what employees should do, and keep close supervision of the task performance
- mainly collaborating (relation-oriented / participative): making decisions, together with the employee, and supporting him / her in the task performance
- directing and collaborating (consultative): asking for the contribution of employees in decision-making, and following the task performance closely
- neither (delegative): leaving decisions and responsibilities for performing the tasks to the employees

t. Can you characterise the relationship between you and your subordinates in a few catchwords?

- formal / informal
- every man for himself / collaborative
- predictable / surprising

u. Do the employees / the representatives (e.g. trade unions or workers congress) involve in important personnel decision-making?

- layoffs
- dismissals
- promotion
- job rotation
- flexible working hours
- overtime
- bonus payments
- wage increase
- housing
- insurance programs
- training opportunities
- fringe benefits
- others

v. Is there any communication between employees or their representatives and management on important decision-making?

- sufficient / not sufficient
- regular / irregular
- often / sometimes / rare

w. Do you have the impression that the actual organisation strongly deviates from the formal rules?

8. Reward and compensation practices

a. Remuneration tied to individuals' performance

- variable wages
- variable bonuses

b. Rewarding tied to profitability of the enterprise

- profit-sharing schemes
- shareholding arrangements

c. Variable pension systems

- early retirement
- forced leave with severance payment

d. Variable social welfare benefits

- provision of company housing
- subsidised health care
- provision of extra health insurance
- provision of extra unemployment insurance

9. Training and education

a. Internal training programmes for employees

- for job enlargement
- for job enrichment
- for general employability
- for procedure rules (new recruits)

b. Management development training programmes

- middle managers
- top managers
- front-line managers

c. Organisation of training

- on-the-job
- learning-by-doing
- in-the-house
- contracting out
- in collaboration with external training institutions

d. Payment of training

- self-payment once ex ante
- cost-sharing
- deduction from salaries ex post

SAMENVATTING (summary in Dutch)

In de transitie naar een markteconomie in China krijgt de zakelijke onderneming in toenemende mate de rol van een economische entiteit in de Westerse betekenis van het produceren van goederen en diensten met winstoogmerk, het scheppen van werkgelegenheid en het opbrengen van belastingen voor de overheid. Dit brengt mee dat arbeid niet langer wordt opgevat als vaste kosten zoals het geval was in de staatsonderneming (SOE). In plaats daarvan wordt arbeid een belangrijke hulpmiddel om het concurrerend vermogen van de onderneming te verhogen voor haar succes, indien en voor zover arbeid flexibel en doelmatig wordt ingezet. Dit heeft als resultaat dat de flexibilisering van arbeid een prominente plaats heeft in het personeelsbeleid (of Human Resource Management) in ondernemingen die concurreren in veelvuldig veranderende afzetmarkten. Hierbij moet de onderneming niet alleen kunnen rekenen op samenwerking en betrokkenheid van de werknemers om de ondernemingsdoelen te verwezenlijken. Het bedrijf moet ook kunnen rekenen op alert en flexibel personeel teneinde de uitdaging van de veranderlijke vraag naar producten onder concurrerende omstandigheden aan te gaan. (Hoofdstuk 1)

Deze analyse op basis van case onderzoek beoogt het vanuit het management perspectief in kaart te brengen van de praktijk te aanzien van arbeidsflexibiliteit op de werkvloer in ondernemingen in China. De centrale onderzoeksvraag luidt *hoe Chinese managers de arbeidsflexibiliteit trachten te vergroten in industriële ondernemingen als reactie op de verscherpte afzetconcurrentie in het veranderende institutionele kader van de transitie economie.*

Deze vraag werd in drie deelvragen onderscheiden:
Vraag 1. Welke typen arbeidsflexibiliteit worden nagestreefd en ontwikkeld op de werkplek?
Vraag 2. In welke mate is het HR-beleid in de onderneming op consistente wijze veranderd om de flexibilisering van het werk te ondersteunen?
Vraag3. Met welke institutionele randvoorwaarden of kansen heeft het management te maken bij zijn poging de arbeidsflexibiliteit te verhogen?

Om deze vragen te beantwoorden zijn tien industriële ondernemingen gekozen uit drie bedrijfstakken in twee verschillende regio (te weten Shenzen en Wuhan). Twee oudere staatsondernemingen in de teruglopende zware machine-industrie zijn gevestigd in Wuhan, terwijl twee pas gevestigde private ondernemingen opereren in de telecom industrie en zes vestigingen van bedrijven (overheid en niet-overheid) zijn te rekenen tot de farmaceutische industrie in respectievelijk Wuhan en Shenzen. De drie industriële bedrijfstakken verschillen in concurrentie en groeimogelijkheden, maar zij hebben veel gemeenschappelijk in termen van kapitaals- of kennisintensiteit. (Hoofdstuk 4)

Shenzen is een van de recent snelgroeiende Speciale Economische Zones in het zuidwesten van China. Hier werden drie pas begonnen bedrijven gekozen in de farmaceutische en telecom industrie. De Wuhan streek is een ouder industriegebied waar vijf oudere

bedrijven en twee pas opgerichte bedrijven uit de drie industriële bedrijfstakken voor dit onderzoek werden gekozen. Shenzen, dat een gunstige beleidsomgeving geniet en soepele arbeidsmarktvoorwaarden kent, is een meer open en verder ontwikkelde regio dan die van het binnenlands gelegen Wuhan. Deze verschillen en de gemeenschappelijke noodzaak van arbeidsflexibiliteit bij concurrerende verhoudingen, zijn van betekenis voor succes of falen van de onderneming. (Hoofdstuk 4)

Het merendeel van de ondernemingen is kennis- of kapitaalintensief, terwijl zij aanzienlijk verschillen voor wat betreft eigendom, leeftijd en managementcoalitie. Elk van hen ervaart evenwel in toenemende mate concurrentie van binnenlandse en buitenlandse rivalen. Teneinde te overleven in de concurrentie in een veranderend institutioneel kader, ontwikkelt het management concurrentiestrategieën vanuit verschillende gezichtshoek (*kostenreductie* of *toegevoegde waarde*) waardoor staatsbedrijven en niet-staatsbedrijven zijn te onderscheiden. De meeste staatsbedrijven richten zich op kosteneffectiviteit, op basis van personeelsreductie en interne herstructurering (o.m. WM-2, WM-1, PhW-1 en PhW-2), terwijl sommige nadruk leggen op een toegevoegde waarde strategie waarbij concurrentievoordeel wordt gezocht in menselijk kapitaal en functionele flexibilisering. (o.m. PhW-3 en PhS-5)

Recent opgerichte private ondernemingen ontwikkelen daarentegen pro-actief gedrag door zowel kostenbeperking als toegevoegde waarde strategie te ontwikkelen, met opvallende nadruk op de kernactiviteiten (o.m. TeleS-2 en PhW-4), waarbij naar diversificatie wordt gestreefd in belendende markten (o.m. PhS-6). Tussen deze extremen valt een gefuseerd bedrijf (TeleW-1) en een nieuw opgericht staatsbedrijf (PhS-5) die kenmerken vertonen van oudere staatsbedrijven dan wel pas gestarte private ondernemingen in hun reactie op marktverhoudingen. De uiteenlopende concurrentiestrategieën die het management ontwikkelt zijn zowel resultaat als oorzaak van het HR-beleid en de arbeidsflexibiliteit in de onderneming. (Hoofdstuk 4)

In dit onderzoek is geprobeerd inzicht te krijgen in een tweetal typen arbeidsflexibiliteit: *numerieke* en *functionele*, elk met uiteenlopende vormen. Het bleek dat numerieke flexibiliteit werkwisselingen, flexibele werktijd en gebruik van tijdelijk personeel) in toenemende mate werd toegepast door het management in elk van de onderzochte ondernemingen. Daarnaast kwamen verschillen voor tussen staatsbedrijven en niet-staatsbedrijven in het streven van het management om het vertrek van werknemers of ontslag hiervan te bevorderen. Collectief ontslag, gesteund door de overheid, kwam voor in alle onderzochte oudere staatsbedrijven die kostenreductie nastreefden door afstand te doen van overtollig personeel. Niet-staatsbedrijven daarentegen waren eerder geneigd individu-gerichte radicale arbeidsaanpassingen door te voeren door het manipuleren van personeelsverloop of vertrek uit de functie. (Hoofdstuk 5 en 7)

Het onderzoek laat zien dat arbeidsflexibiliteit verkregen langs de weg van de numerieke dimensie direct leidt tot kostenreductie, waardoor de arbeidsproductiviteit stijgt. Kosteneffectiviteit is de overheersende beleidsfilosofie voor het management van het technisch-uitvoerend personeel in alle onderzochte ondernemingen. Het overvloedige aanbod van ongeschoolde arbeid in China verschaft het management de gunstige omstandigheid om de numerieke flexibilisering volledig uit te proberen, dit omdat

substitutie bij deze categorie werkers op de arbeidsmarkt gemakkelijk is. Deze werknemers worden daarom benaderd als 'randpersoneel', gegeven het ontbreken van hun ondernemingsspecifieke opleiding en training. Dit laatste kan evenwel de verbetering van de arbeidsproductiviteit op de langere termijn ondermijnen. (Hoofdstuk 5 en 7)

In dit onderzoek blijkt, in overeenkomst met hetgeen in de literatuur naar voren komt, dat de flexibilisering van arbeid niet succesvol is zonder ondersteunend HR-beleid. Dit beleid moet intern consistent zijn en het dient te passen bij de externe omgeving van de onderneming. Dit onderzoek laat zien dat strategieën van kostenreductie en toegevoegde waarde ofwel het bestaande HR-beleid transformeren dan wel bijgedragen tot de ontwikkeling van nieuw beleid. In ondernemingen met consistent HR-beleid kan het management de mogelijkheden van arbeidsflexibilisering verkennen zonder (veel) schade te berokkenen aan de betrokkenheid van werknemers bij flexibele arbeidsrelaties (TeleS-2, PhW-4, PhS-5 en TeleW-1). Ondernemingen daarentegen met onvolledig consistent HR-beleid of tegenstrijdige kenmerken bij verzelfstandigde staatsbedrijven (WM-2, WM-1, PhW-1 en PhW-2) lopen op tegen enorme dilemma's wanneer het management afstand probeert te nemen van het oude HR-beleid en de arbeidsflexibiliteit wil vergroten. Het meest beluisterde dilemma in samenhang met de consistentie in het HR-beleid in staatsbedrijven is die waarbij het management getalenteerde werknemers gemotiveerd moet houden op de langere termijn onder omstandigheden van verhoogde flexibiliteit op de werkplek. Dit brengt mee dat dilemma's in samenhang met consistentie van het HR-beleid vaker zijn te verwachten in oudere staatsbedrijven waar het HR-beleid deels marktgestuurd is en deels gevangen zit in de hiërarchische sturing van het oude personeelsbeleid. Inconsistentie is geworteld in de erfenis van vroegere personeelsbeleidsmethoden (o.m. toewijzing van werk, functie en salaris door de staat) die nog werkzaam zijn in de transitie economie. Dergelijke erfenissen zijn zelfs waar te nemen als tegenstrijdigheden in beleid en praktijk in nieuw gestichte staatsbedrijven (o.m. Phs-5). (Hoofdstuk 6)

Uiteraard hebben locale arbeidsmarktomstandigheden invloed op het ontwikkelen van arbeidsflexibiliteit en adequaat HR-beleid. Ondernemingen in het kustgebied van de Speciale Economische Zone Shenzen zijn sterker marktgeoriënteerd in hun HR-beleid en –toepassing dan ondernemingen in het binnenlands gelegen Wuhan-gebied, op grond van uiteenlopende wet- en regelgeving van de centrale regering (zie Hoofdstuk 4). Ondernemingen in Shenzen hebben te maken met striktere regulering dan hun tegenhangers in Wuhan met betrekking tot het aantrekken van tijdelijke werknemers en migratiewerkers van de arbeidsmarkt. In weerwil hiervan profiteren ondernemingen in Shenzen van relatief soepele arbeidsmarktaanbod en passen zij meer flexibele werkpraktijken toe dan vergelijkbare bedrijven in Wuhan. Gegeven de ruimere toepassing van flexibilisering van het werk en de sterkere marktsturing van het HR-beleid voor de werkvloer, vertonen de staatsbedrijven in Shenzen (o.m. PhS-5), vanuit het gezichtspunt van regionale werkers, meer gelijkenis met ondernemingen in de private sector in Wuhan. Met andere woorden, recent gestichte bedrijven in Shenzen tonen geringe overeenkomst met kenmerken van staatssocialisme, zelfs bij staatseigendom. (Hoofdstuk 6)

Private ondernemingen zijn derhalve de meest flexibele bedrijven. Staatsondernemingen blijven inflexibel, niettegenstaande dat hier de rigiditeit in tewerkstelling afneemt. Een

vergelijking tussen bedrijfstakken geeft aanwijzingen dat twee niet-staatsbedrijven in de telecom de grootste flexibiliteit hebben ontwikkeld in deze groeiende en concurrerende sector. Aan het tegenoverliggende eind van het flexibiliteitspectrum vinden wij twee inflexibele staatsondernemingen in de afkalvende machinebedrijfstak. Binnen de farmaceutische sector is een overeenkomstig patroon waar te nemen: flexibele private ondernemingen en inflexibele staatsbedrijven concurreren met elkaar om het marktaandeel. Alle onderzochte ondernemingen in aanmerking genomen, is een algemene trend vast te stellen: oudere staatsbedrijven streven naar flexibiliteit, maar zij ondervinden nog steeds het nadeel van een gering aanpassingsvermogen. Dit laatste is in hoofdzaak toe te schrijven aan het relatief oudere werknemersbestand en de bureaucratische managementstijl, kenmerk van de erfenis van instituties in het staatssocialisme. (Hoofdstuk 5 en 7)

Klaarblijkelijk bestaan aanzienlijke verschillen in speelruimte voor het management om arbeidsflexibilisering uit te proberen in de ondernemingen binnen het ruimere kader van de-institutionalisering en re-institutionalisering die samengaan met de transitie economie in China. Doorgaans zijn managers in staatsbedrijven sterker onderworpen aan institutionele randvoorwaarden (zoals overheidsloonpolitiek, arbeidsplaatstoewijzing en benoeming van het management) dan managers in private ondernemingen in het ontwikkelen van marktgeoriënteerde consistente HR-stelsels ter ondersteuning van grotere flexibiliteit op de werkplek. Staatsbedrijven die 'halverwege' de transitie verkeren lopen op tegen de beperkingen als gevolg van inconsistenties in hun pogingen om arbeidsflexibilisering van de grond te krijgen. Dit komt omdat de vereiste re-institutionalisering nog niet of onvoldoende is voortgeschreden dan wel te kort schiet in de transformatie van overheidsbedrijven in de marktconcurrentie. Dit heeft tot gevolg dat de bereikte stand van zaken voor arbeidsflexibilisering onevenredig is verdeeld over de bedrijfstakken en tussen ondernemingen binnen bedrijfstakken, zowel als tussen de regio. (Hoofdstuk 2 en 8)

De institutionele nalatenschap weerspiegelt zich in het bestuur van de staatsbedrijven en in de stijl van het management. In het doorsnee hervormde overheidsbedrijf bestaat de dominante coalitie uit de Partij Secretaris en het algemeen management die benoemd worden op gezag van de staat voor een bepaalde periode (gewoonlijk drie tot vijf jaar). Zowel de samenstelling als de normen en waarden die binnen en buiten de topleiding worden gedeeld hebben vergaande invloed op HRM. Door het recente programma van verzelfstandiging verschuift de machtsbalans in de dominante coalitie in de overheidsonderneming van de Partij Secretaris naar de algemene manager dan wel worden beide functies geïntegreerd en uitgeoefend door de algemeen manager. Het gevolg hiervan is dat de interne wrijvingen tussen Partij Secretaris en de algemeen manager in belangrijke mate verminderen. Aldus wordt het gezag van het management over de gang van zaken in de verzelfstandigde ondernemingen gevestigd. In weerwil van het toegenomen gezag van het management in de SOEs, blijft de loopbaanontwikkeling van de topleiding hier meer afhankelijk van bureaucratische regels dan van ondernemerssucces in de turbulente zakenwereld. Dit komt tot uiting in het gedrag van de overheidsmanagers die vooral actief reageren op verwachtingen van toezichthoudende instellingen, terwijl zij intussen het dagelijks management als tweede belang zien. Verhoudingsgewijs ondervinden de niet-overheidsbedrijven minder stringente randvoorwaarden dan de SOEs en mede daarom kan

de topleiding in private ondernemingen in sterkere mate ondernemerschap en minder bureaucratisch gedrag aan de dag leggen. (Hoofdstuk 2 en 7)

Naast de topleiding speelt de *ondernemingsvakbond* en het *vakbondscongres* van werkers op basis van de wet een belangrijke legitimerende rol voor de behartiging van de belangen van de werknemers tegenover de managers in de staatsbedrijven. De formele rollen van beide instanties blijken echter in de meeste onderzochte staatsbedrijven verzwakt door de overheersende zeggenschap van het management over de werknemers in hun werksituatie. In het bijzonder is de status van het vakbondscongres afgenomen vis-à-vis de nieuwe raden van bestuur, doordat het congres zijn toezichthoudende rol zag overgenomen door de vergadering van aandeelhouders na de verzelfstandiging van de staatsondernemingen in de jaren ’90. De ondernemingsvakbond, hoewel volop aanwezig in elk van de onderzochte staatsbedrijven, is praktisch gesproken ondergeschikt aan het gezag van het management. Dit is temeer het geval omdat de benoeming van de vakbondsvoorzitter geschiedt op voordracht van het locale bestuur, na overleg met de topleiding van het staatsbedrijf. De ondergeschikte positie van de vakbondsvoorzitter vloeit in wezen voort uit de conflicterende rollen die de vakbeweging in staatsbedrijven zijn toebedeeld: enerzijds de belangenbehartiging voor de werknemers in de organisatie en anderzijds de steunverlening aan de topleiding bij het management van het arbeidsproces. (Hoofdstuk 2 en 8)

Terwijl de rol van de *Communistische Partij Organisatie* in de onderzochte ondernemingen in toenemende mate beperkt is tot niet-bestuurlijke activiteiten (zoals het bewaken en verzekeren van de implementatie van het overheidsbeleid), is het interessant te zien dat elk van de onderzochte private ondernemingen vrijwillig een *Partij Bureau* hebben ingesteld voor de werknemers-leden in de organisatie. De aanwezigheid van dit Bureau in de private ondernemingen wordt verdedigd door de topleiding voor het *‘zakelijk gemak’*. Daartegenover zijn vakbonden, zoals de wet verlangt, niet aanwezig in elk van de private ondernemingen van het onderzoek. In het bijzonder ontbreekt het Vakbondscongres in de private ondernemingen, terwijl het in alle staatsbedrijven bestaat. Het Partij Bureau en de vakbond (voor zover aanwezig) in de private onderneming vormen evenwel geen onderdeel van de dominante coalitie in het topbestuur. Evenmin als hun tegenvoeters in de overheidsbedrijven treden de Communistische Partij Organisatie en de vakbonden in de private ondernemingen op als tegenmacht tegenover het managementgezag. Er wordt doorgaans en ondersteunende rol van het Partij Bureau en de vakorganisaties in de private onderneming verlangd door het management. Een andere belangrijke rol is het ontwikkelen van externe kanalen om doelgericht contact te leggen en te onderhouden met overheidsinstanties. (Hoofdstuk 2 en 8)

Klaarblijkelijk is het instellen van een Partij Bureau dan wel ondernemingsvakbond in het private bedrijf gunstig voor het management in zijn streven om nadelige gevolgen van de onvoorspelbaarheid van de economische omgeving te minimaliseren. Ten minste drie voordelen zijn: (1) het ontwikkelen van een imago van legitimiteit in de maatschappij, (2) het verkrijgen van een formele erkenning door het locaal bestuur en (3) niet langer plunderend bestookt te worden door arbitrair ingrijpen van externe toezichthouders. Met andere woorden, het instellen van een Communistisch Partij Bureau, en in mindere mate van vakbonden, is in de private onderneming een strategische keus van de topleiding om zaken gedaan te krijgen en te vermijden wat noodzakelijk is onder omstandigheden van

transitie. Private ondernemingen proberen nadelen van extern institutionele schokken op te vangen door het symbolisch instellen van organen in de organisatie die de overheid welgevallig zijn. Het management in staatsbedrijven bepaalt zich tot individueel opportunistisch gedrag door persoonlijke relaties met externe toezichthouders te cultiveren ten koste van de doelmatigheid. (Hoofdstuk 3, 6 en 8)

Gegeven het zich verder ontwikkelende institutionele kader in China, zijn de strategische keuzen van het management op het HR-beleid van belang voor het ondernemingsresultaat onder de veranderende interne en externe randvoorwaarden. Het empirisch onderzoek laat duidelijk proactieve en reactieve aspecten zien bij de besluitvorming van het management vis-à-vis de omgeving. Hoewel bleek dat het management in staatsbedrijven grotere autonomie krijgt, het ondervindt niettemin nog steeds beperkingen door toezicht van externe overheidsinstellingen. Evenals hun tegenhangers in private bedrijven kunnen managers in staatsbedrijven initiatieven nemen ten aanzien van de buitenwereld, zoals de keus een markt te betreden of te verlaten. Ook kunnen zij intern aanpassingen maken, zoals verdergaande professionalisering van beleid en uitvoering op het HR-gebied. Tegelijkertijd brengt de institutionele omgeving randvoorwaarden mee ten aanzien van de vrijheid in het managementgedrag. Nu de zich ontwikkelende instituties in China meer en meer openheid bieden voor flexibele interpretaties, ziet ook het management van staatsbedrijven zich gedwongen te reageren op terugkoppelingen van de omgeving, wil de organisatie niet het risico lopen van afstraffing door markt of institutionele omgeving. Dit managementgedrag biedt managers de mogelijkheid om te leren de transactiekosten in de veranderlijke commerciële omgeving te minimaliseren. (Hoofdstuk 3 en 8)

De dynamiek van interacties is van belang bij het minimaliseren van transactiekosten op het HRM-gebied, tussen de ondernemingsleiding en de medewerkers, tussen de vertegenwoordigers van de onderneming en toezichthoudende instanties, en uiteindelijk tussen keus en randvoorwaarde. De onderzoeksresultaten laten duidelijk zien dat bij het streven van het management om de arbeidsflexibiliteit te verhogen verschillende randvoorwaarden en mogelijkheden van betekenis zijn. Managers in staatsbedrijven ervaren hierbij vaak meer stringente voorwaarden dan hun tegenhangers in private ondernemingen. Maar het management in staatsbedrijven probeert soms voordeel te behalen uit de institutionele erfenis van staatseigendom bij het minimaliseren van transactiekosten (bijvoorbeeld door het uitbesteden van R&D activiteiten naar onderzoekinstituten van de overheid). Private ondernemingen daarentegen moeten overleven in de marktconcurrentie en zij hebben weinig kans op het verkrijgen van deze vormen van overheidssteun. Niettemin proberen deze managers het gedrag van hun tegenvoeters in staatsbedrijven na te bootsen door goede relaties met overheidsfunctionarissen te cultiveren om betere condities voor de operaties van hun onderneming te verkennen. (Hoofdstuk 3 en 8)

Vanuit het gezichtspunt van bronafhankelijkheid dragen de toegenomen markttransacties in de overheidssector in China er toe bij dat de afhankelijkheid van het management in de staatsbedrijven voor essentiële bronnen en prijssubsidies van de centrale overheid in belangrijke mate afnemen. Een manier om deze afhankelijkheid te reduceren, zoals dit onderzoek laat zien, is door externe partijen te internaliseren en goede relaties op te bouwen met invloedrijke personen die formeel buiten de organisatie staan. Het resultaat is

dat ondernemingen en toezichthoudende instellingen verweven raken door samenwerking tussen sleutelfunctionarissen bij het streven naar bescherming van de kernactiviteiten tegen nadelige externe invloeden. Het onderscheid tussen *'onderneming'* en *'markt'* en tussen *'markt'* en *'bureaucratie'* vervaagt aldus aanzienlijk naarmate het management betrokken raakt in *'buffering'* en *'bridging'* ten aanzien van nadelige externe invloeden. Naarmate de externe afhankelijkheid afneemt moeten de ondernemingen concurreren op de markt om de benodigde middelen, waaronder medewerkers. Daarbij, zoals eerder opgemerkt, vormen de medewerkers een waardevolle bron om een concurrentievoordeel te krijgen en te handhaven. Zoals dit onderzoek laat zien hebben ondernemingen die er in slagen hooggeschoolde werknemers aan te trekken en hen op flexibele wijze in te schakelen, betere resultaten. (Hoofdstuk 3 en 8)

De conclusie is dat het succes van de onderneming in de transitie van China naar een markteconomie niet alleen besloten ligt in goedkope arbeid, maar veeleer in de beschikbaarheid van hooggeschoolde en gemotiveerde werknemers die flexibel worden ingeschakeld. Voor overleving en continuïteit van bedrijfsvoering in een toenemend concurrerende omgeving neigt het Chinese management naar *numerieke flexibilisering* bij uitvoerende productiewerkers (perifere werkers of laaggeschoolde arbeidsreserve) die gemakkelijk vervangbaar zijn op grond van een overvloedige aanbod door heel China. Hiervoor heeft het ondernemingsmanagement speelruimte nodig om aanpassing in de arbeidsbehoefte te maken op basis van eenvoudige aanname- en ontslagprocedures voor ongeschoolde werkers, het toepassen van korte termijn contracten en geringe investeringen in opleiding en loondifferentiatie naar gelang de arbeidsmarktsituatie. Anderzijds wordt *functionele flexibilisering* voornamelijk nagestreefd voor managers en technische medewerkers (kernmedewerkers of geschoolde arbeidsreserve) wier vaardigheden relatief schaars zijn in China. Hiervoor moet het management effectieve manieren vinden om vaardige medewerkers te behouden en hun toegevoegde waarde flexibel te benutten door, bijvoorbeeld, schema's te ontwikkelen voor loopbaanvooruitzicht, opleiding, vaste aanstelling, bonussen en opties op aandelen. Uiteindelijk zijn de uiteenlopende vormen van arbeidsflexibilisering reflecties van de strategische overwegingen van het management bij het op een lijn brengen van de kosten van arbeid met verschil in scholing en prestatie, om de fluctuaties van productie wegens marktwijzigingen door te voeren. Arbeid is een belangrijke bron voor het concurrerend vermogen en ondernemingssucces wanneer de werknemers doelmatig en flexibel worden ingeschakeld. (Hoofdstuk 8)

De twee besproken flexibiliseringstrategieën worden gelijktijdig gehanteerd binnen eenzelfde organisatie, maar voor verschillende segmenten van de werknemers. Beide strategieën vertegenwoordigen elementen van de twee beleidsstragieën van het management: *kostenreductie* en *waardevermeerdering.* Deze strategieën zijn op hun beurt overwegend ingegeven door twee benaderingen in het concurrentiebeleid (*kosten-vermindering* en *kwaliteitsverbetering*) die de onderneming kan volgen om concurrentievoordeel te behalen. (Hoofdstuk 8)

Echter, de mate waarin arbeidsflexibilisering op de werkplek tot stand komt hangt grotendeels af van het ondersteunend HR-beleidskader dat marktgeoriënteerd is en interne consistent is. Bij veranderingen in het HR-beleid van de onderneming moet rekenschap worden gegeven van de product-markt concurrentie, de locale arbeidsmarktomstandig-

heden en de politiek-institutionele omgeving die tot uiting komt in de eigendomstructuur, leeftijd en de interne leidinggevende coalitie van de onderneming. Algemeen gesproken geven zowel private ondernemingen als recent gevestigde joint ventures met buitenlands kapitaal de toon aan bij het adopteren van flexibele arbeid op de werkplek, ondersteund door consistent HR-beleid op ondernemingsniveau. Staatsbedrijven daarentegen liggen achter, wegens verschillende randvoorwaarden die de aanpassing aan marktverhoudingen en de transformatie naar een consistent HR-beleid in de weg staan. Naar gelang de transitie naar een markteconomie vordert, kunnen ondernemingen in China evenwel niet langer profiteren van het overvloedige aanbod van goedkope arbeid.

CURRICULUM VITAE

Yongping Chen was born on February 2, 1964 (Chinese calendar) in a small village of Hubei Province, People's Republic of China (PRC). He was admitted to Fudan University Shanghai in 1981, and graduated with a Bachelor degree in Economics in 1985. From 1985 to 1991, he worked as a researcher in the Hubei Academy of Social Sciences in Wuhan, PRC. In 1992, he was awarded a scholarship by the Ford Foundation for a graduate study of international trade and finance at The John Hopkins University-Nanjing University Center, Nanjing, PRC. Afterwards, he became a financial analyst, as well as a securities dealer at the Wuhan International Trust and Investment Company. In 1994, he received a Netherlands Government Fellowship for a graduate study of Employment and Labour Studies at the Institute of Social Studies, in The Hague, the Netherlands, and graduated in 1995 with a distinction on his master thesis. In March 1996, he started as a PhD candidate (or AIO) at the Rotterdam School of Management/Faculteit Bedrijfskunde of the Erasmus University Rotterdam. Since February 2000, Yongping Chen worked as a credit controller and business analyst in an IT company near Rotterdam, the Netherlands.

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