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CHALLENGES OF FINNISH AND JAPANESE COMPANIES IN THE CHINESE BUSINESS ENVIRONMENT: RELATIONS WITH THE LOCAL LABOUR FORCE

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1 INTRODUCTION

With its ‘open door’ policies since the late 1970s, China began to gradually allow foreign direct investments (FDI) in the country. Investments were first permitted in joint-ventures, and later also in other modes of operation, as China increasingly deregulated some of its restrictions to FDI. In the early 1990s, China began to transform from socialism to a ‘socialist market economy’. This policy proved successful, with the Chinese economy growing continuously for the last 30 years. In the aftermath of the global financial crisis, the gross domestic production (GDP) of China grew around 9 % in 2011. Also the GDP per capita increased ten-fold during the last two decades, and further, China recently became the world’s second largest economy and the world’s largest manufacturing producer that attracts the bulk of international FDI.

The Chinese government has steered foreign investors e.g. by promoting investments in certain sectors and restricting others. Nowadays, most of the investments are made to wholly foreign-owned enterprises in manufacturing industries. China has also become rather dependent on foreign investors that produce around a fifth of China’s GDP and contribute to over half of its exports. While the largest sources of FDI to China are Hong Kong, Taiwan, Singapore and Japan, also European companies are increasingly operating in the country. For example, the Finnish telecommunications giant Nokia has been a major investor in China. (Kosonen et al. 2011)

However, the Chinese business environment is rather challenging for most foreign investors due to the difference from their home country environments. One source of challenges is the Chinese labour market that has been under rapid change along with the transformation and reforms of the economy. In this study, we are interested in looking at the experiences of foreign companies, especially those from Finland and Japan, on the Chinese business environment and its labour market. Our specific aim is *to identify the main*

challenges in the companies' relations with the local labour force and the solutions that they have adopted in these relations.

Our study is motivated by two issues. First, companies from Finland are increasingly investing in China that has rapidly become an important market and a production base for various Finnish industries. In 2010, China emerged as the largest destination of FDI flows from Finland, surpassing Sweden, and amounting to one third of total Finnish outward FDI. The combined turnover of the around 300 Finnish firms established in China is 18.5 billion euros reflecting the relatively large size of the companies that mainly operate in engineering, electronics, IT and telecommunications. Second, Japanese firms have been among major investors in China already since the early 1990s and hence have an important role in the overall economy. Their cumulative FDI stock is over tenfold compared to Finnish firms, and therefore, they have a much longer and wider experience in operating in the Chinese business environment. The main sectors of Japanese investments have been, for example, transport equipment and foodstuffs industries, as well as finance and insurance. Both Finnish and Japanese investments have been motivated, originally, by lower production costs, and more recently, by the growing market potential in China. The operation modes have varied from joint-ventures to wholly foreign owned enterprises, following the gradual liberalization of the Chinese company law.

In this vein, our focus will be on firms from Finland that are fairly recently established in China, and those from Japan, one of the biggest investors in the country. The two home economies share some similarities as investment sources; Finland and Japan are relatively similar as to the level of development, structure of the economy, and per capita income levels. However, they are rather different when it comes to their role in the Chinese economy: Japan was already in the early 1990s the biggest trading partner for China (Hattori 2004a), and in 2010, it was still the main import source. In comparison, Finland is still a small actor in the Chinese economy with the appr. 190 subsidiaries employing around 50,000 people. The value

of Finland's trade is less than 3 %, and its FDI stock less than 10 %, of Japanese trade and FDI in China, respectively. Similarly, the number of Finnish companies is only 5 % of the nearly 5,500 Japanese companies established in China. (For further comparative data on Finnish and Japanese trade and investments in China, see Table A1 in the Appendix.)

In our previous studies on the operations of Finnish companies, we have found that the problems they face in the Chinese business environment have been related to, for example, the public sector, other companies, and labour force (Kettunen et al. 2008). Challenges in the relations with the public sector have included issues such as unclear legislation, heavy bureaucracy, and regional differences in the implementation of laws. Many of these are also related to the labour force, such as changes in labour legislation and unclear enforcement of laws. Further, we have found that Finnish firms have faced similar challenges in their labour relations in other emerging economies, such as Russia and South Korea, including the lack of qualified labour, high indirect costs, and problems with the local work culture (Kettunen et al. 2007). These are comparable with some earlier research on Japanese companies on the specific issues they have encountered in human resource management in China, such as the gradual localization of management to Chinese managers, a high turnover rate, and an in-house training system (Mizoguchi and Nakamura 2007).

Research design

To compare between the experiences of Finnish and Japanese firms, empirically, we draw from our interview data from Finnish firms operating in China and mirror this with findings on Japanese firms from previous literature (e.g. Hattori 2004a). The study employs a longitudinal qualitative analysis that is made to point out the aspects that the companies have found most challenging in their employee relations when operating in China. The primary data consists of interview records from the database of the Center for Markets in Transition, of the Aalto University School of Economics. The original interviews deal with the challenges

that companies face in their relations with the state, other companies and labour force in China. For the present study, data regarding labour force were picked from the database.

The data source consists of altogether 87 interviews of which 73 were made with Finnish managers and 14 with Chinese managers of Finnish firms established in China or their local partner firms (see Table A2. in the Appendix). Data collection was performed between 2003 and 2011 by semi-structured open-ended interviews in order to allow the respondents identify key problems and solutions in the companies' labour relations in China. All data was handled anonymously. Information about Japanese companies was picked from previous research, as well as from the personal discussion with prof. Hattori, to provide comparative insights for the study. In addition, secondary data such as companies' annual reports, and articles from business newspapers were used as supplementary information.

As in qualitative analysis in general, the data reduction process involved the coding of the interview material, i.e. breaking it down into discrete chunks (Malhotra & Birks 2005). Analytical categories were produced from the respondents' statements, and findings were grouped according to relevant categories related to challenges and solutions, and were then compared between Finnish and Japanese companies. While the companies represent various ownership structures and industry branches, we do not elaborate on sectoral differences, but rather, focus on host country specific issues. Regarding locations, the analysis focuses on regions where the operations of Finnish and Japanese companies are concentrated: most Finnish firms are located in the Eastern coastal region, including the Shanghai, Beijing, and the Pearl River delta regions. The Japanese firms, in turn, are typically located in the North-eastern coastal areas, such as the Dalian region. While recognizing that our results are not necessarily generalized to the country as a whole, for practical reasons we refer to China instead of the exact locations when describing our empirical findings.

This report is structured as follows: in the next section, we briefly discuss the theoretical background of the study related to the institutional approach and the concept of

governance (chapter 2). Based on the company data, we then describe the challenges that Finnish and Japanese firms have faced in their labour relations and the solutions to these challenges (chapter 3). Finally, we discuss the findings, and elaborate on the similarities and differences between the companies from Finland and Japan (chapter 4). While they share many experiences in the Chinese business environment, a closer analysis reveals certain differences between companies from Finland and Japan that are related to the socio-cultural roots and organizational practices of the two home countries.

2 THE IMPACT OF FORMAL AND INFORMAL INSTITUTIONS ON CHINESE LABOUR MARKET

When discussing the business environment of a transitional economy, in particular, we benefit from an institutional approach that takes into account the constraints provided by the norms and practices of the host economy. North (1990) defines an institutional framework of a nation as ‘the rules of the game in a society’. Institutions can be divided into *formal institutions* that include, for example, laws, regulations, and contracts, and *informal institutions* that point to norms, cultures and practices. Both provide constraints for actors when they pursue their own interests. The formal rules provide the ‘rule book’ for the game, whereas informal practices represent a commonly understood way in which the written rules are interpreted and applied when playing the game. Many key institutions that govern the behavior of economic actors are nationally specific.

In China, the institutional environment has been changing during the last decades due to economic transition and reforms. There have been changes in the formal and informal institutions that affect the labour market. Earlier, the labour system of the socialist command economy was based on a fixed wage system (the so-called *iron wage*) and characterized by life-time employment (*iron rice bowl*) and the inflexibility of the workers to change jobs (*iron chair*). These have been gradually abolished in the socialist market economy with changes in legislation to allow private ownership and the privatization of the Chinese state-owned enterprises (SOE). Also, the relaxation of the work unit system has increased labour mobility: the earlier *danwei* system¹ that restricted the movement of workers is being replaced by a more allowing household registration system, *hukou*.²

Overall, the reforms have decreased the amount of government planning in labour market and have brought the system to gradually become more market-oriented, especially in

¹ *Danwei* is a specific work unit typical in Chinese state-owned enterprises. Before the reforms, the work unit was a central element of the Chinese justice system, and it gave or denied workers the permission to marry, move, travel, and have children. The work unit provided housing, schools, medical care and services to workers, who often remained in the same *danwei* for a lifetime. The system has been markedly relaxed during the 2000s.

² *Hukou* is a Chinese system of residency permits that officially identifies a person as a resident of an area.

the main urban areas. As the lifetime employment has been abolished, the relations between enterprises and labour have changed significantly toward flexibility and managerial control (Gallagher 2004). Employees are nowadays more able to choose their workplace, as the centralized labour allocation of the *danwei* system has been abandoned. Also recruiting practices have become more market-driven and merit-oriented, and companies can focus on the abilities and skills of the candidates. With the shift towards a labour capital system, the political background of a candidate does not count as much as earlier, and jobs are less inherited (Zhu & Dowling 2002).

While in general, formal institutions may change relatively quickly with changes in legislation, informal institutions such as socio-cultural characteristics are prone to be more constant. One of the central informal institutions of the Chinese society is the tradition of personal networking in economic life, i.e. the systems of *guànxì* (relationship) and *guànxìwang* (net of interconnected relationships) that are built on strong mutual interdependence. This is similar to many other transitional economies, such as Russia, where business life is based on networking, especially if the formal institutional environment is weak. When there are no reliable formal rules, such as a stable legislation, informal institutions function to complement them (Peng et al 2008). The importance of networking has remained central in the Chinese everyday business life, and it still has a role e.g. in recruiting and in building connections to the state sector and partner companies, for example.

2.1 Challenges in foreign companies' labour relations

From the perspective of foreign companies, the characteristics of the institutional environment in China have had a major effect on their labour relations. These have been visible in, for example, recruiting practices, the general availability of suitable workforce, and the skills of employees. For Western companies, one of the major challenges has been to match the organizational culture and management style with the qualifications of the Chinese

employees. In the early 1990s, the reforms were at an early stage and since the traditional decision system in China had involved government authorities, local managers did not have experience on how to make autonomous decisions, as required by foreign companies (Tsang 1994).

Likewise, Japanese companies have been facing similar kinds of challenges related to the management of their operations in China. They have largely implemented a Japanese system of management based on sending Japanese expatriates to run the operations in China (Legewie 2002) which might be a source of challenges due to cultural differences in management styles. However, the extent of sending Japanese expatriates has varied significantly from one industry to another, and also region-wise (Taylor 1999; 2001). Hence there have been differences in the level of localizing the management of Japanese companies in China. The challenge of Japanese firms has been to develop a system for training and promoting of Chinese managers in order to strengthen localization and the authority of local companies (Hattori 2004a).

Further, since Japanese firms tend to have higher rates of unionization than other foreign companies, they have used trade unions as a mediating institution between managers and employees. However, they often present labour friction as a cultural problem despite of their ability to use the unions in solving problems. It is perceived that long-term investment plans require a positive public image in China (Gallagher 2004).

More recently, new kinds of challenges have emerged in foreign companies' labour relations in China. One of these has been the high rate of employee turnover, i.e. job-hopping of local work-force. In order to overcome the problem, companies have found various ways to engage and motivate the personnel, such as through competitive salaries and bonuses. Further, some companies have provided shared ownership for the employees in the so-called shared-stock ownership companies. This was based on China's reforms to allow private ownership and the privatization of the SOEs (Law et al. 2003).

The international conventions that China has implemented as part of its WTO membership in 2001 have resulted in the introduction of individual work contracts (Zhu & Warner 2004). This has been a further tool for the employers to retain qualified employees. Both foreign companies and Chinese SOEs have typically applied long-term or open-ended contracts for skilled workers in attempting to limit the high employee turnover, while for non-skilled workers, contracts have often been short-term and informal (Gallagher 2004). Japanese companies have generally used a long apprenticeship period combined with a one year employment contract and a possibility to extend the contract to the second year.

With its new Labour Contract Law since 2008, China has aimed to improve the rights of especially the non-skilled workers. The law has changed the legal environment related to work contracts, as it stipulates the companies to have a written work contract with all employees. In addition, the use of terminable contracts is limited, and unlawful dismissal of workers is more expensive than previously (Shen 2007).

2.2 The governance of labour relations

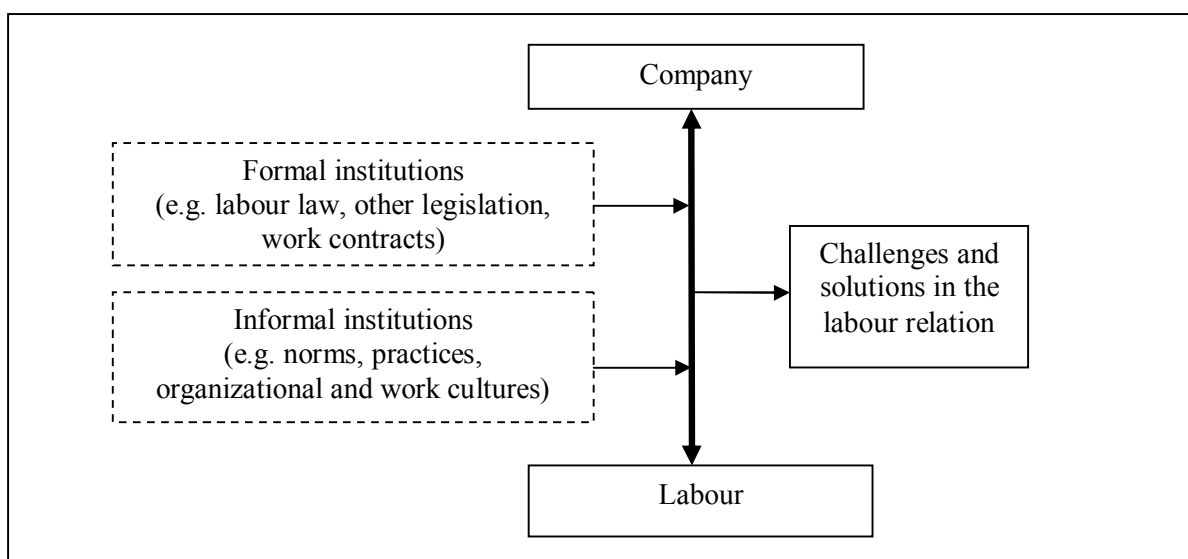
The developments described above give rise to various challenges that Finnish and Japanese companies may face in their relations with the labour force in the Chinese business environment. In order to analyze the impacts of formal and informal institutions on the companies' labour relations in China, we draw from the governance approach (Amin and Hausner 1997; Jessop 1995; 1997; Kosonen 2002; 2005). Governance refers to the various coordination mechanisms that actors use in order to mitigate problems in mutual relations and to create joint practices in cooperation. When analyzing governance in economic action, attention is given on the various problems that undermine relations between actors, as well as the problem solving practices that actors develop in order to alleviate the problems. Hence the

governance approach focuses on the various coordinating practices between persons and organizations, such as the political and economic domains of the society (ibid.).

In our study on companies' employee relations in China, we focus on the problems and challenges that Finnish and Japanese companies identify in their relations with the labour force. Also, we depict their ways of solving these problems. Successful governance of labour relations depends on the ability to solve the problems: governance fails when problems remain intact, and it succeeds when problems are solved.

Being embedded in the local socioeconomic and political setting (Granovetter 1985; Grabher 1993), foreign firms' labour relations are subject not only to the company labour policy, but also to the institutional environment of the host country. Hence, our study is based on a conceptual framework that portrays the institutional setting (Figure 1). The coordination of the company's labour relation is affected both by formal institutions (e.g. labour law) and informal institutions (e.g. norms and practices) that are specific to each host country. As depicted in Figure 1, both formal and informal institutions have an impact on the coordination of the foreign firms' employee relation. These institutional constraints give rise to challenges in the labour relations that are specific to each business environment.

Figure 1. The relation between the company and labour in the host economy.



Source: Modified after Kosonen (2002) and Kettunen et al. (2007).

In our empirical analysis, the dimensions of the above conceptual model are discussed to the extent that they were pointed at in the interviews with the firms' representatives. Therefore our study sheds light to the most relevant factors in the firms' labour issues in the Chinese business environment, rather than provides a full account of all the dimensions of the conceptual model. Also, where appropriate, we depict the companies' challenges and solutions with sensitivity to the time dimension. Thus our empirical analysis, presented next, includes not only information on the current state-of-the-art of labour relations in China, but also pays attention to the practices affected by the legacies of the socialist command economy.

3 CHALLENGES OF THE FINNISH AND JAPANESE COMPANIES' LABOUR RELATIONS IN CHINA

Our findings indicate that Finnish and Japanese investors face relatively similar challenges in their labour relations in the Chinese business environment. The problems in managing the labour relations in China can be divided under two main categories: the availability of suitable labour, and the challenges related to organizational and work cultures. First, the availability of qualified labour is closely related to the high turnover of employees, need for training, and the increasing cost of labour force in China, as experienced by the companies. Second, the challenges induced by differences in organizational cultures are related to securing the resources of the company, the division of job responsibilities between expatriates and local employees, as well as intercultural communication issues. The latter was found to manifest evident differences between the Finnish and Japanese companies, as well as Chinese ones, when it comes to hierarchies, organizational structures and communication styles.

3.1 Availability of qualified labour

The main challenge repeatedly mentioned by the interviewees is related to the supply of suitable labour in China. Since many foreign firms have initially invested in functions that are labour-intensive, the availability of skilled labour is critical for the success of operations. The need for specialized skills has become even more crucial, as more and more investments are made in functions such as research and development (R & D). Many companies report about the lack of qualified employees, both workers and managers. The recruitment of new employees is often difficult, expensive and time consuming.

In general, managers for top and middle management are more difficult to recruit. Finding specialists, such as accounting managers, financial directors, or certain technical

experts, can be especially complicated. Partly this is due to the scarcity of talent that has led to competition between local and international companies. In particular, finding competent Chinese sales persons has been challenging, and further education conducted by the company is often necessary. Selling 'quality' is perceived a demanding task for even experienced Chinese sales people who are used to the old ways of conducting business.

For Finnish companies, employees with specialized skills and an ability to speak English are the most difficult to find. This concerns especially employees with an understanding about Western culture and management style, as well as business field experience and knowhow. Skills in English are emphasized, as Chinese employees often have to communicate with foreign customers, as well as with foreign colleagues either in China or in the headquarters. In comparison, office workers and less educated work force have been more abundantly available.

Japanese companies have experienced similar kinds of problems in recruiting. On the one hand, they find it difficult to hire Chinese middle managers, because local people competent for such work are typically unwilling to follow the Japanese style of being employed first to the bottom of the organization, and then slowly proceeding upwards in the hierarchy and eventually to managerial positions. On the other hand, Japanese companies are also short of Japanese managers who would understand the business environment in China. Thus, Japanese companies face a 'double problem' of a lack of suitable managers. Since Japanese companies typically recruit local personnel, some have felt the growing competition for workforce especially by local and Taiwanese companies.

Beneath the general observation about the challenge of finding suitable employees there is some variation in the availability of employees according to the location of the company. Especially in times of high economic growth, the most challenging areas are the so-called first-tier cities and major growth centres. In the Shanghai region, some Finnish companies have been unable to find employees due to rapidly rising costs and hard

competition for labour. Also in Guangdong in Southern China, there has been a shortage of local labour force and companies have had to recruit migrants from other parts of the country.

In addition, the experiences on the quality of labour force vary according to the mode of operation. Challenges have emerged in some joint ventures, especially in the 1990s, when the existing Chinese staff had been used to working in traditional state-led organizations. Some Finnish firms have also got personnel through acquisitions, and views on recruiting through acquisitions have been relatively negative. Excess and unsuitable workers in joint ventures or acquired companies are difficult to lay off after the operations have started.

Recently, the global economic crisis has affected the Chinese labour market by close-downs and massive layoffs in some export intensive industries, such as clothing, shoes, and toys. In particular, there has been increasing unemployment among young graduates who could not find jobs due to layoffs during global economic crisis. This is leading to a situation where labour force is becoming older due to the lack of social ‘safety nets’. Despite the economic slowdown, most Japanese companies have stayed in China, however, in contrast to around 3,000 Korean and Taiwanese companies that have left the country. Japanese firms have adopted, for example, so-called job-sharing programs in which two or possibly more employees share a single job. This has allowed the companies more flexibility, but has also sometimes led to a situation of ‘one step forward, two steps backward’ when production has remained at a low level due to weak market demand. (Hamamoto 2010)

Need for training

Most Finnish interviewees consider Chinese employees to be well educated, hard-working and eager to learn new skills. However, older Chinese generations who have experienced the Cultural Revolution are perceived as less able to cope with Western business culture. This has often been related to earlier joint-venture cases where the Finnish side has acquired some of the personnel directly from the Chinese partner, often an old state-owned

enterprise, and the skills of the workers have not met the needs of the Finnish company. Related to this, the traditional Chinese management style has been problematic for Finns who see it too military-like or too much 'hands-on' leading to a lack of initiative among the employees. This situation is however changing gradually, as the Chinese business environment is globalizing with more and more foreign influences.

One field of competence that both Finnish and Japanese companies have difficulties to find, especially in sales and after-sales services, is customer orientation and the spirit of valuing the customer. This is especially so regarding the Japanese culture, where 'the customer is the God' (after the Japanese saying *o-kyaku-sama wa kami-sama desu*). There is a stark difference in this respect between the two business cultures. In addition, one reason for the lack of customer orientation in the Chinese context might simply be the huge size of the market that leaves a single customer of little value.

Also, companies that need professionally skilled employees often find even experienced Chinese candidates not competent enough. For Finnish companies, one of the main problems is the lack of persons who would have both specific professional skills, and a good command of English language. Hence the employees will need education irrespective of their previous work experience. As education may be arranged in Finland or elsewhere in Europe, a new problem emerges: Chinese employees tend to take the trips to Finland more like tourist visits. Eventually, if the education is less in focus, the whole training becomes rather useless for the company.

High turnover as an additional problem

Once companies have managed to recruit qualified workers, they face challenge of retaining the employees. As in other emerging economies, the long term economic growth and increasing wages have led to frequent job-hopping and a high rate of employee turnover in China. For Finnish companies, the annual employee turnover at around 20-30 % is a greater

problem than, for example, the skill level of the employees. Especially young Chinese seek for opportunities to achieve better salary and benefits, and since job options for qualified employees are numerous, they tend to change their employer quite often. Most of those who change jobs are office workers, specialists and engineers; instead, factory workers can get only smaller wage raises, and their turnover rate is smaller.

According to a Finnish interviewee, the average staying time for an employee is three years. A particularly challenging task is to keep those staff members that the company has offered education or training. The employees typically want to collect the benefit of their increased value at the labour market and offer their competence for another company soon after education. Especially valuable is the training offered by a foreign company, causing the trained employees to leave after just one year. As training and education provided in the company is relatively expensive, the continuous training of new employees is very costly for the companies, and makes the accumulation of know-how difficult. In some cases, after employees have received some education they have started to “consider themselves as irreplaceable” which has resulted in growing wage rise demands. Hence, training ultimately becomes rather expensive as the Chinese tend to change jobs for a better wage and benefits.

Similar to the Finns, also Japanese companies have experienced the effects of high turnover rate. They feel, for example, that Chinese managers are not loyal to the company in the way that the Japanese would expect. Instead, they perceive that the Chinese want to be promoted quickly and are seeking new opportunities outside the Japanese companies if they find the promotion system too slow. This is in stark contrast to the Japanese organizational culture where employees are gradually promoted in the hierarchical ladder of the organization.

The high turnover rate is an indicator of the difficulties that both Finnish and Japanese companies face in motivating their Chinese employees. For example, it is not typical for Finnish companies to offer quick career development and promotion possibilities through a

hierarchical organization, where employees would be able to pursue better positions and higher status. Instead, Finns tend to have rather flat organizations and a spirit of equality between colleagues and organizational layers, which makes the Chinese feel uncomfortable. Related to this is the problem of differentiating the salaries of employees strongly enough in order to maintain the good performance of the skilled workers. Finnish managers also seem to have difficulties in integrating their Chinese employees into the ‘inner circle’ of the company. Some of them indicate that they have failed to create an emotional bondage between the company and employees that the Chinese would need. Furthermore, Finnish firms typically implement the motivating measures only to key employees, such as sales teams, although strong motivating would be needed in all teams in order to keep the employees in the company.

The motivating problems are shared by Japanese companies, too: they find it somewhat challenging to encourage their Chinese employees, albeit due to different reasons. It seems that often problems are related to cultural differences and even historical burdens of Japan-China relations, and this resonates in the relations between Chinese workers and Japanese managers. Our data indicates that Chinese employees may even feel guilty of working in a Japanese company due to, for example, the political tensions between the countries (Hattori 2011), or that they feel that the Japanese are arrogant by attitude – both of which clearly weaken the attractiveness of Japanese companies as employers.

Rapidly rising labour costs

A major challenge interwoven with the availability and high turnover of employees is the ultimate cost of employment due to the rapidly rising wage level in China. Originally, the relatively low costs were the main driving force for foreign companies to establish production facilities in the country. Workers’ wages were directly controlled by the Chinese state, and this included both differentials and the size and type of bonuses paid (Gao 1996, 72). Along

with economic reforms, the wage level has gradually been linked to the skills and position of the personnel. Wages in China have risen considerably during the last decade, and differentials have increased between more and less educated employees. More recently, the new Labour Contract Law from 2008 has further increased the minimum wage level and tightened the terms of employment resulting in higher costs for the employers.

Yet direct wages only account for a minor part of the ultimate costs for the company, and the training of the personnel forms the biggest additional expense, especially when education is arranged abroad. The high turnover rate and continuous training further increases the costs, as qualified employees are able to race potential employers and get the highest possible pay, when demand for them is larger than supply. Hence the wage demands of the candidates include substantial negotiation scope, and also the level of desired salaries varies significantly between prospective employees. Especially small Finnish companies find it difficult to define a proper wage level for individual employees, as there is no such union-based negotiation system as in Finland. Generally, foreign companies pay more than domestic ones, and Finns note that especially some of their American competitors are paying relatively high salaries. Sometimes Chinese companies pay better for the top management positions, however.

Lately, differentials between the wage levels of more and less educated workforce have increased rapidly in China. Factory workers are clearly less paid and have less negotiation scope over their salaries when recruited. One result has been a wave of strikes in some Japanese companies in recent years, some of which have caused notable production stops in the plants (Hamamoto 2010).

Although the rising cost level is a general trend in China, there is considerable regional variation in wage levels. Both Finnish and Japanese firms have faced the challenge of rising labour cost in the coastal regions. Many Japanese companies are located in the coastal regions close to Japan, and are experiencing the increase in costs due to the shortage of

inexpensive labour force. At the same time the general wage level in inland regions and Western China is only about a quarter of that in the coastal areas, and in manufacturing, the differences are even bigger. The age of workers also has a role, as older employees are more willing to stay inland and work for smaller pay, while younger ones are more likely to move to coastal areas in search for higher salaries. Some foreign companies consider that especially in the first-tier cities, such as Shanghai, the wage level is too high as the productivity of the workers is not rising as rapidly as the wage level.

3.2 Solutions for engaging qualified labour with reasonable costs

When looking for suitable workforce in China, all companies have to compete hard for qualified workers and managers. Companies use various channels, such as local networks, to find and recruit personnel based on the intended role and responsibilities of the potential employee. Usually, Finnish companies resort to head-hunters and fairs when hiring managers, whereas they use advertisements and employment agencies in blue-collar recruiting. Also, companies often hire personnel with the help of local executives. The advantage is that the locals are acquainted with the employment system and the wage level, and can use their personal networks, *guànxìwang*, in recruiting. Often, the key personnel may also bring some of their own colleagues with them.

Younger employees are often hired directly from universities due to the lower wage demands and the possibility to train them “from scratch”. Companies report about successful recruitment of qualified engineers from good Chinese universities, as well as of those with a foreign education. The willingness to educate new employees in the company itself clearly helps in finding suitable candidates for recruitment. As the Chinese tend to be highly motivated in learning, they regard the possibility to advance inside the organisation important, and career development is usually discussed already in the recruiting interviews.

Similarly, Japanese companies use various methods when finding qualified middle management in their Chinese units. When Japanese managers best fit for the management positions are scarce, the solution is to localize these positions in order to get Chinese managers with an understanding about the local business environment. In doing this, the Japanese companies have to create a promotion and training system that suits the local culture to attract skilful Chinese managers. Sometimes companies resort to looking for employees outside of their location, if there is a lack of qualified employees due to high competition (Komagata 2009).

In cases when companies get personnel through acquisitions or from their Chinese partner, it is necessary to negotiate about the future of the partner's employees before the official beginning of the co-operation, as firing the excess and unsuitable employees afterwards has proven to be difficult. This is further complicated by the fact that the Chinese investment legislation is characterised by region-specific and industry-specific restrictions and conditions (cf. Kaislaniemi 2003). Hence Finnish companies often find it useful to unite forces with other Western firms in the region.

Skills development

As a solution for the need for developing the skills of the employees with training of education, many Finnish managers prefer to hire mainly young Chinese persons who are ready to learn, because the older generations in China may have difficulties to adapt to Western business practices. Also new graduates are typically recruited since they are easy to train to their tasks. Finnish companies often search for skilful Chinese who have experience of working in Western companies. Education is a way to train for the tasks, but it is also a means to reward and motivate employees in China. Especially the personnel who are in human resource management, production management, accounting, production engineering and R&D, are often educated in the Finnish home base of the companies. Education in Finland or

elsewhere in Europe usually takes weeks or months, or even one year. Sometimes the high costs of education are lowered by sending the training personnel from Finland to China instead.

Also Japanese companies typically train their personnel either in China or in Japan, depending on the status of the employees in the organizational hierarchy. In many cases, also the training is localized after the operations have been established in China originally by the Japanese managers. Sometimes education provided by the company is controlled by tests. For example, when a Japanese company educates personnel in quality management, the employee must complete the education and pass the examination in order to get a wage rise. The results of the examinations are shown publically as the Chinese consider this more equal (Komagata 2009). Similarly, hands-on training is needed in order to expand the awareness of services and customer orientation among Chinese employees.

Motivating the personnel

When dealing with the high turnover rate, the primary tool of companies is to put into practice various measures to motivate employees in drawing them to stay within the company. According to Finnish interviewees, salary is the most important motivating measure for Chinese personnel. Especially young employees value high wages, and they are therefore offered competitive salaries. Besides the actual salary, a benefit package attached to it is a key to attract Chinese employees. Benefits could include bonuses, accommodation, health care, pension and insurance.

Also many Japanese companies typically offer accommodation and meals advantages to staff members. In some cases, improving the benefits has resulted in a clear decline in turnover rate, from 30 % to around 10 % (Komagata 2009). Another important measure is to provide avenues for career development. Therefore Finnish organizations in China are more hierarchical than those in Finland, since hierarchy makes it possible to at least nominally

promote employees every now and then. Some Finnish companies prefer to recruit female workers to certain production tasks, as women are considered more loyal to the employer.

In addition, if the employer has a clearly growing business, Chinese employees are motivated and feel that there is space to build their own future within the firm. Other sources of motivation and engagement include the reputation and reliability of the employer, good working conditions, long-term contracts, giving recognition, task circulation, education and possibility to travel abroad. Permanent employment is appreciated especially by older employees, and Finns notice that the Chinese workers consider long work contracts a sign of employer's commitment and loyalty.

Other factors that may engage employees to the company are, for example, an attractive company culture, community spirit, politically neutral environment as well as the possibility to give feedback and participate in developing the business. For Japanese firms, the motivating measures can, for example, take the form of creating functions that enable contribution to the society, as Chinese workers want to contribute to the common good of their country. This might imply curtailing some of the 'Japaneseness' of the company and instead, highlighting the common good of the Chinese society. It seems that Japanese companies need to be more sensitive than Finnish ones about national feelings, as Finns may benefit from the neutrality of Sino-Finnish relations and the lack of political burdens between the countries.

In addition to the somewhat subtle motivating measures, there have also been some more direct measures to overcome the problem of high turnover of foot-loose workers. Some Finnish companies have asked their personnel to sign a contract of committing to work for the company for certain years after being trained, or alternatively, pay back the training costs. This has been successful in some companies; instead some report that the Chinese employees just ignore such contracts when leaving the firm. Many Finnish firms have simply adapted to

the high turnover rate as a status quo and have maintained a larger recruitment function than is necessary in Finland.

Defining the real cost level

In tackling the higher than expected cost level, the critical issue for the firms is to define the eventual costs of employment. This requires balancing between competitive wages to motivate the staff and the cost of training employees due to the high turnover. Since there is plenty of room to negotiate and reconsider wages, the Chinese salary system takes into account the skills and achievements of employees. To define the actual employment costs including all the benefits and training needed it is vital to reconsider wages on an annual basis. To do this, many Finnish companies are constantly monitoring the wages of their competitors. On the other hand, other foreign companies can often pay more than especially small Finnish ones who try to manage the wage level by using consistent principles of defining salaries. They also perceive that Chinese employees appreciate fair treatment and a possibility to get wage raises according to rules common to all. Equal opportunities are promoted by articulate company policies. This way, Finns are to some extent successful in keeping their key personnel and, at the same time, can maintain a sustainable wage level.

As the wage level is rising especially in the coastal areas of China, several Finnish firms have considered relocating their operations either to inland China where incentives are still available, or elsewhere in Asia, such as India or Vietnam, where operation costs are lower. If relocation is not feasible, some Finnish companies are recruiting new employees from outside the large cities. Also Japanese firms, facing the lack of inexpensive work force in the coastal regions, need to consider the possibility to move their operations to the new focus areas of China: Central and North-eastern parts of the country. The Chinese government's new 5-year plan puts emphasis on the Western and Central parts of the country and provides incentives for businesses to relocate their operations to inland China.

Also, as universities in inland cities nowadays offer a pool of educated workers, and infrastructure is being built, more and more foreign companies find it feasible to move operations in these regions to balance the labour cost level and availability of qualified work force. However, some Japanese companies have found the strikes caused by the low wage level as problematic, and have, subsequently, increased their wage level in China considerably. For example, Honda increased their employees' wages by 24 % due to strikes in their Chinese plants. (The Economist 2010)

3.3 Differences in organizational and work cultures

Companies also face challenges in managing and organizing the daily tasks functionally, related to the division of job responsibilities among expatriates and local employees. In securing company resources, Finns underline the necessity of control especially in the establishment phase of the subsidiary, and the need to keep the business, payments, and prizing in Finnish hands. Financial control is particularly emphasised due to the observation that Chinese workers may have a blurred idea about the difference between company and personal assets and may not consider it dishonest to use company money for one's own expenses.

There is a further challenge related to differences in the employees' qualifications. Some Finnish companies find it difficult to ensure that all tasks would be completed properly without their presence. They perceive the Chinese employees as reluctant to take responsibility and being afraid of failure, resulting in an inability to proceed without precise work directions. On the other hand, the lack of trust has confused some of the local managers, who feel that Finns do not give the Chinese employees enough space to develop themselves and take responsibility.

One of the main challenges, faced both by Finnish and Japanese companies, is related to the differences in organizational cultures, such as the role of hierarchies. The organizational cultures differ greatly between all the three countries. To begin with, Finnish organizations are relatively flat, and employees can be characterised, in general, as highly skilled, initiative-taking and used to team-work. Recruiting is based on competencies and education. In Japan, in contrast, even skilled employees are expected to start at the bottom of the organization that is hierarchical with many layers. This is markedly different from what the companies experience in China.

The challenges of Finnish companies, in particular, concern the management of the Chinese employees. Traditionally, Chinese organisations are very hierarchical and workers are used to taking orders from their superiors. Therefore local employees have difficulties in adapting to Finnish flat organisation structures. Sometimes Finns feel that Chinese employees, especially in lower organizational levels, expect managers to be ‘father figures’, and they find it uncomfortable to act as “the boss”.

Likewise, Japanese companies face challenges in terms of hierarchy and intercultural issues in China, but in a different way. As the traditional way of employment in Japanese enterprises is to hire new staff first to the bottom of the organization, it is difficult for them to find qualified Chinese managers who would be willing to start from the lower hierarchical levels. Also, for Chinese employees the speed of promotion is too slow in a Japanese company that, typically, would promote personnel gradually from the bottom towards managerial positions.

Furthermore, these problems are related to their difficulties in cross-cultural communication. Especially, communication between Finns and Chinese is often a challenge, both in terms of the actual language skills and the way of using language. The lack of a

common language causes problems, since most of the Finns do not speak Chinese, and most of the local workers especially outside the main urban agglomerations are generally unable to understand English. Instead, midlevel managers usually have better English skills than regular employees.

Also the communication patterns differ markedly between Finns and Chinese. Often, Finnish managers in China feel that local employees try to hide their uncertainty and pretend to know what they are doing even if they do not, especially in the beginning of their employment. In addition, problems are hidden, and Finns interpret this behaviour to happen for saving one's face. Finnish managers also find it challenging to encourage some of the Chinese employees to express their opinions, as they tend to use ambivalent words. There are also differences in using the various means of communication; Finns are used to communicating via e-mail, while Chinese prefer face-to-face meetings.

In addition, Japanese companies report that they receive little feedback from the work site. Hence there seems to be a lack of communication between the Chinese unit and Japanese parent company. On the other hand, Japanese managers may experience that Chinese workers have a weak sense of order in the workplace. This, too, might be related to basic differences in work cultures.

Copying and theft as problem

Securing the technology of the company, both among Finns and the Japanese, is challenging since Chinese managers are hungry for learning and good at adopting business models and products. It is not rare that workers copy their employer's products in order to establish their own competing business. Problems related to intellectual property rights (IPR) are reported by Finns both in green-field investments and in mergers and acquisitions. Also the Japanese have indicated some uncertainty about securing their technologies. While earlier, Japanese companies often brought in old technologies due to the risk of copying and stealing,

nowadays there are fewer opportunities to utilize obsolete technologies in the more developed Chinese market. The need to use newer technology brings about the challenge of IPR violations.

Some Finnish firms have witnessed their Chinese employees, especially in the purchasing department, to pursue personal financial goals that are in conflict with the company interests, which makes the control of local operations difficult. It is typical in China for the purchase manager to engage in chicanery, i.e. to make a personal profit by fixing the prices with the seller. The problem is that the purchasing and sales persons are hard to replace by expatriates, since it is seen that in China, only the locals can buy and sell in the local market. Both Finns and Japanese consider that foreigners are not the best personnel in this regard in China.

3.4 Solutions for organizing the work and adapting to local culture

In order to maintain control as well as to secure the technology and finance of the companies, both Finnish and Japanese companies typically create a division of responsibilities among the local and expatriate managers. This is largely based on the strengths of employees and the requirements of each managerial position. In Finnish companies, certain positions are allocated to Finns or overseas Chinese (usually, managers from Hong Kong or Singapore), such as the positions of managing director, financial manager and production manager. On the other hand, Chinese managers are often handed the control and decision making over human resource management, product development, material management, purchases, sales, logistics and administration.

Adapting to hierarchies and communication styles

As to the differences in the parent firms' and the local work culture, Finnish and Japanese companies have found various ways to adapt to the local environment. Finnish companies often increase the number of organizational layers of their Chinese unit in order to make the Chinese employees feel more comfortable and motivated than in flat Finnish organizations. This also enables frequent promotions of the staff members. Organizational layers for positions such as an 'assistant director' or a 'foreman', not used in Finland any more, are typically applied to the Chinese units. In order to give Chinese employees the feeling of a father figure, i.e. the Chinese way of management, more strict control has been adopted in some Finnish companies.

An alternative solution is to blend Finnish and Chinese management styles: to conduct Finnish management culture in higher organizational levels, and implement Chinese style with close follow-up and monitoring in the lower ones. In comparison, some companies have localized the organization altogether, and let the unit operate according to the Chinese work culture with high hierarchies and strict control over workers. Often, the eventual adaptation seems to differ, however, according to the size of the company: it is perceived by the interviewed Chinese employees that small Finnish companies remain less hierarchical.

Similarly, Japanese companies have tried to adapt to the local work culture where it is difficult to retain managers at the lower levels of the organization. Their solution has been to find new ways to promote Chinese managers in order to attract them to Japanese organizations, where the traditional promoting system emphasizes seniority in the service of the company. Many organizations are localized relatively quickly (cf. Komagata 2009) and Chinese managers are hired directly to managerial positions. In addition, the career advancement of local managers may be much faster than traditionally in Japanese companies.

Problems with the local work culture, such as the lack of initiative or difficult communication that many Finnish companies face, are generally avoided by the careful selection of both expatriates and local employees. Many Finns are of the view that the subsidiary should be run by an expatriate; some larger companies have as many as 30 Finns in China in the starting phase. While it takes time and effort for an expatriate to adapt to the Chinese way of working, living, building the *guànxìwang* and getting to know the important authorities, Finns feel it necessary to build even a modest network. This reflects a sustained stand of company operations and intentions, as Chinese authorities prefer long-term presence of the expatriate instead of short work visits.

As regards cross-cultural communication with the company's key personnel, many Finnish companies prefer to have a Chinese person with fluent English skills as the accountant. Several companies also use an interpreter. However, as companies put emphasis on language skills of Chinese staff, they prefer to hire university graduates with some work experience and English skills. In addition, some interviewees resort to more local ways in communicating with the locals, such as more face-to-face discussion and multimedia communication instead of only e-mails, and hiring overseas Chinese with better language skills. A further solution is to gradually localize the operations, which Japanese companies have resorted to in order to overcome the problem of a lack of communication between the Chinese unit and Japanese parent company.

Securing IPR and resources through division of responsibilities

For Japanese companies, the main reason to keep control over their operations in China has been the need to secure technology. One solution has been to bring only old technology to China. As this has not been feasible in the long run, another way to control the IPR has been to send Japanese managers to monitor the situation in China.

According to both Finnish and Japanese interviewees, sales personnel should be Chinese, and preferably also male, since the customers are male. At the same time, many companies find female workers most suitable as office workers. Most Finns also regard that the bookkeeper should be a Chinese person with good relations to the local authorities, as well as a good command of English in order to be able to communicate with the Finnish board of directors.

In many Finnish-Chinese joint-ventures, the Finnish side provides the technology and handles the production, and the Chinese take care of customer relations, public relations and relations to the local work force. As Chinese employees may find the division of job responsibilities ambiguous, many Finns find that the liability distribution of the workers has to be plainly clarified. Some Finnish managers are of the view that even simple tasks are tolerated by Chinese employees when defined in detail with precise job descriptions and work instructions. Often, Finns feel that Chinese employees are reluctant to take responsibility being afraid of failure. One way to encourage the willingness to be more independent is a higher salary which motivates a Chinese worker to be more active.

On the other hand, expatriate Finns typically offer support for the Chinese in the establishment phase of the operations, after which all or most of the positions are localized. Expatriates are often present also in order to get things done in an acceptable way from the Finnish company's perspective. At the same time, the presence of the Finns may function as a monitoring tool, to get things done and to avoid malpractices. However, not every Finnish company has an expatriate presence in China. Instead, the solution in these cases is to localize the organization and recruit Chinese only. This has proved to be successful for several companies.

3.5 Summary

In this section, we have discussed the challenges that Finnish and Japanese firms face in their employee relations in China. It has been found that problems emerge especially concerning the availability of suitable labour, high turnover, need for education, high labour costs, organizational cultures, division of job responsibilities, and differences in work cultures. We have also drawn attention to the solutions that the companies find in tackling these challenges. Based on the data on Finnish and Japanese companies, the challenges in their employee relations in China are found to be solved in various ways. The solutions typically include using specific recruiting channels, implementing measures to motivate Chinese employees, training the employees, defining the ultimate cost level, defining the job responsibilities, and adapting to the local work culture. These include features, some of which are unique to either Finnish or Japanese enterprises. We draw together these similarities and differences below in Table 1 that summarizes the study by grouping the results in four categories:

- Common problems and solutions for Finnish and Japanese companies
- Common problems for Finnish and Japanese companies, partially different solutions
- Common problems for Finnish and Japanese companies, different solutions
- Specific problems and solutions for Finnish and/or Japanese companies

First, there was one common problem for Finns and the Japanese that was also tackled in a similar way: the need to secure intellectual property rights. The common solutions were to bring older technology to China, to limit the staff members' access to IPR, and to monitor the possible copying or theft closely. Second, there were several common problems that were solved in partially different ways. These included the availability of suitable managers, differences in work cultures, the rapidly rising costs of labour, and challenges in cross-cultural

communication. For all these, the Finns and Japanese shared some solutions (such as localizing the management of the Chinese unit) while they also engaged in specific ways to tackle the problems. The Finnish companies created more organizational layers in order to motivate the employees through possibilities for career development, whereas the Japanese companies hired managers directly to upper positions, contrary to the traditional Japanese organizational culture (Table 2).

Third, both Finns and the Japanese faced the problem of motivating the easily job-hopping Chinese employees to stay within the company, albeit in different ways. The Finnish companies stressed the need to create good working conditions and an attractive company culture, while the Japanese firms were more prone to emphasize their providing for the common good for the Chinese society. Finally, there were various challenges and solutions that were typical only for either the Finnish or the Japanese firms. These included, for example, the Finns' perception of the traditional Chinese management being too military-like that led them to hire younger personnel not affected by direct experiences of the Cultural revolution. The Japanese firms found it difficult to find competent Japanese managers to run the company in the Chinese business environment, which was often solved by localizing the management of the Chinese unit.

Table 1. Challenges and solutions of Finnish and Japanese companies' labour relations in China.

	Finnish companies	Japanese companies
COMMON CHALLENGES AND SOLUTIONS		
Challenge	Securing IPR	
Solutions	<ul style="list-style-type: none">- Using old technology in China- Limiting employees' possibilities to copy products or other materials- Bringing expatriates from the home country to monitor and control the operations	
COMMON CHALLENGES, PARTLY DIFFERENT SOLUTIONS		
Challenge	Availability of qualified Chinese managers	
Solutions	<ul style="list-style-type: none">- Looking for managers outside of company's location	
	<ul style="list-style-type: none">- Using head-hunters, fairs and local networks to find suitable candidates	<ul style="list-style-type: none">- Localizing the organization, allowing local management style- Creating a promotion and training system that suits the Chinese culture
Challenge	Differences in work cultures between the parent company and the Chinese unit	
Solutions	<ul style="list-style-type: none">- Localizing the organization, allowing the implementation of local hierarchies	
	<ul style="list-style-type: none">- Creating more organizational layers that enable frequent promotions- Blending Finnish and Chinese management cultures (Finnish management in higher organizational levels and Chinese in lower ones)	<ul style="list-style-type: none">- Finding new ways to recruit and promote Chinese managers by hiring them directly to managerial positions and promoting them faster than usual in Japan
Challenge	Rapidly rising labour costs in coastal areas, escalated by high employee turnover and the need for training	
Solutions	<ul style="list-style-type: none">- Relocating operations to inland China or elsewhere in Asia- Recruiting employees from outside of the large cities	
	<ul style="list-style-type: none">- Monitoring the competitors' wages- Using consistent principles of defining salaries	<ul style="list-style-type: none">- Raising salaries to avoid strikes

Challenge	Communication with Chinese employees	
Solutions	- Localizing the organization	
	- Carefully selecting expatriates and local employees - Hiring university graduates to ensure English skills - Implementing locally preferred communication	
Challenge	Lack of customer orientation among Chinese employees	
Solution	- Training in company's home country or in China	
		- Hands-on training on the job in China

COMMON CHALLENGES, DIFFERENT SOLUTIONS

Challenge	Motivating qualified employees to stay within the company	
Solutions	<ul style="list-style-type: none"> - Increasing the organizational layers to offer opportunities for promotion - Competitive salary and a benefit package including accommodation, bonuses, health care, pension and insurance - Creating avenues for career development, giving recognition, task circulation, education - Ensuring good reputation, reliability, good working conditions, long-term contracts - Engaging employees with attractive company culture, community spirit and politically neutral environment 	<ul style="list-style-type: none"> - Implementing motivating measures, such as enabling employees to contribution to the society - Highlighting the common good for Chinese society and curtailing the 'Japaneseness' of the company in order to ease the discomfort felt by Chinese employees by political tensions and historical burdens between China and Japan, as well as to lessen the Chinese employees' experience of Japanese being arrogant - Offering salary and benefits, such as accommodation and meal advantages

	Finnish companies	Japanese companies
SPECIFIC CHALLENGES AND SOLUTIONS		
Challenge	Finding Chinese employees with a combination of specialized skills and an ability to speak English	Finding Japanese managers with understanding about the business environment in China
Solution	- Vocational training in Finland, elsewhere in Europe or in China	- Localizing the organization and using Chinese management
Challenge	Excess and unsuitable workers from Chinese partner company in joint venture or through acquisition	Excess workers due to decreased demand in export markets
Solutions	- Discussing about the future of the employees before the joint venture agreement or acquisition is made to avoid layoffs afterwards	- Job-sharing programs to avoid layoffs
Challenge	Job-hopping or high wage rise demands of employees trained within the company	Hiring Chinese managers to lower positions of the company
Solutions	- Contracts of committing the employee to stay in the company for a specified time - Collecting the costs of training from the employee who is leaving - Maintaining a larger recruitment function than in Finland	- Finding new ways to promote Chinese managers by hiring them directly to managerial positions and promoting them faster than usually in Japan
Challenge	Defining a proper wage level and the ultimate costs of employment	
Solutions	- Using consistent principles of defining salary levels	
Challenge	Traditional Chinese management style perceived as too military-like	
Solutions	- Recruiting young managers who are ready to learn Western business practices - Recruiting Chinese with experience of working in Western companies	

Challenge	Job responsibilities too ambiguous for Chinese employees	
Solutions	<ul style="list-style-type: none"> - Precise job descriptions and work instructions - Division of responsibilities among local and expatriate managers 	
Challenge	Problems with work culture (copying, reluctance to take responsibility, fear of failure, hiding problems)	
Solutions	<ul style="list-style-type: none"> - Control over financial issues by Finns - Clarifying the liability distribution of the workers - Finns to monitor and control the operations and to avoid malpractices - Higher salary to motivate Chinese workers to take responsibility 	
Challenge	Expensive training in Finland taken as tourist visits by Chinese employees	Controlling the effectiveness of education offered by the company
Solution	Localizing training by sending Finnish educators to China	Testing employees

According to our findings, hence, the supply of labour force in China is often a challenge regarding the needs of the foreign companies. When companies manage to find suitable labour, the high turnover of Chinese employees makes it difficult for the companies to cumulate knowledge and know-how in their Chinese organization. In addition, the overall costs of employment are often higher than expected, due to the employee turnover and the relatively high extra costs in addition to basic wages. Also the perceived lack of management skills of the Chinese employees, as well as the continuous need for training and education result in high operational costs. Besides the need for training and education, interviewees reported about challenges related to ambiguities of job responsibilities. Finally, there are evident differences between the foreign and local work cultures, such as hierarchies and communication styles, which create challenges in managing the operations of Finnish and Japanese firms in China.

4 DISCUSSION

In this paper, we have analysed the employee relations of Finnish and Japanese companies operating in the rapidly changing markets of China. Our aim has been to identify the challenges and problems in labour relations, and to compare between the experiences of Finnish and Japanese companies in this respect. Theoretically, the study has drawn from the institutional approach (North 1990) discussing formal and informal institutions. We have applied the concept of governance (Amin and Hausner 1997; Jessop 1995; 1997; Kosonen 2002; 2005) of social relations, looking particularly at the formal rules and informal practices in the coordination of foreign companies' employee relations in a host country. The empirical analysis has been founded on a database of interviews with Finnish companies operating in China, complemented with findings on Japanese companies from earlier research. Based on the data, we have described the various challenges in the companies' employee relations in China and the solutions that companies have resorted to in order to overcome these challenges.

Reflecting our theoretical framework, we can summarize the findings of the study as follows. The company's labour relation is affected by two sets of local influences, i.e. the formal and informal institutions of the host economy. On the one hand, formal institutions in China have included the legacies of the earlier socialist system, such as life-long employment, fixed wage system and labour immobility. While they are still partly in place and thus also affect the operations of foreign companies, the recent labour market transition along with the 'socialist market economy' has somewhat changed these practices towards Western conventions of flexible employment and wage systems. Changes in legislation, such as the new Labour contract law of 2008, have also affected the companies' relations with their work force. The turbulent business environment, with changes in legislation and interventions of

the government, has made the Chinese business environment challenging for foreign companies.

On the other hand, the informal institutions of the host country reflect the importance of local networks and changes in work cultures in China. The local network such as the system of *guànxìwang* has proved to be decisive in the way foreign companies succeed in the Chinese business environment. In addition, the company's labour relation is affected by changing work cultures and value systems that are typical of transforming economies.

We have found that the company's labour relation is affected by the above characteristics of the local environment, which brings about several challenges identified by the Finnish and Japanese companies operating China. These include the availability of suitable labour, high employee turnover, indirect labour costs, lack of managerial skills and need for continuous education, ambiguities in the division of job responsibilities, and local work culture. These challenges have been solved in various ways in the interviewed companies. Typically, Finnish firms have resorted to specific recruiting channels and measures to motivate Chinese employees, defining the ultimate cost level, training the employees, defining the job responsibilities and adapting to the local work culture. One solution to adapt to the local work culture was to increase the number of hierarchical layers in the organization. In contrast, Japanese companies needed to find ways to recruit Chinese employees to managerial positions directly, and not starting from lower positions as is typical in Japan. These depict different kinds of governance mechanisms in the companies' labour relations.

The results provide insight into the specific challenges that Finnish and Japanese companies face in the Chinese business environment. In their labour relations in China, the firms are guided by local institutions, such as legislation, norms and practices. The Chinese public sector sets the guidelines for the foreign companies' relations with the local labour force, and at the same time, foreign companies are faced with local practices and procedures

in the labour market. For foreign firms, these appear as institutional constraints that bring about challenges the companies need to solve in various ways. Hence the study highlights the companies' need to adapt to the institutionally complex business environment of China. In addition, the findings draw attention to the characteristics of companies from different countries, Finland and Japan, and the differences in their experiences. This has allowed us to discuss also the home country effects of foreign companies, and the differences in the constraints that they face in the Chinese institutional environment.

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APPENDICES

Table A1. Comparison of Finnish and Japanese trade and investments in China, 2010.

	Finland	Japan
Imports from China	5.0 billion USD	152.8 billion USD
Exports to China	3.6 billion USD	149.1 billion USD
Annual flow of FDI to China	2.0 billion USD	7.3 billion USD
Cumulative FDI in China	5.7 billion USD	66.5 billion USD
Number of companies in China	260	5,460
Main sectors of FDI in China	engineering, electronics, information technology	transport equipment, foodstuffs, finance, insurance

Sources: Jetro 2011, Finnish Customs 2011, Finpro 2010, METI 2011, Bank of Finland 2011

Note 1: In 2010, Japan was the largest source of imports in China (13 % of all imports). At the same time, the EU was the largest export target (20 % of total exports). Of individual countries, in comparison, the USA was the most important export target (18 % of total exports), while Japan's share of China's exports was 8 %.

Note 2: Both Japan and Finland have a trade deficit with China. While Finland's trade deficit was 16 % of the value of Finnish trade with China in 2010, Japan's was 1 %, respectively.

Table A2. The number of interviewed persons by the companies' industry.

Industry	Finnish managers	Chinese managers
ICT and electronics	12	1
Engineering	15	5
Chemistry and forestry	8	2
Other industries	13	3
Services and trade	25	3
<i>Subtotal</i>	<i>73</i>	<i>14</i>
<i>Total</i>	<i>87</i>	