The Motivation, Facilitation and Limitations of HRM Practice Diffusion: A Study of Chinese Multinationals

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ABSTRACT

With the increasing global integration, diffusion of “best practice” is a critical activity in an MNC, in particular, MNCs from countries who have recently joined in global markets to learn the best practice in their international operations. In the current research on MNCs’ HRM diffusion, ‘reverse diffusion’ is argued to be an important approach in the internationalisation of managements. However, there is little empirical evidence in support of this argument. This paper uses the UK subsidiaries of Chinese MNCs as an example to explore the nature of the diffusion activities in these companies and its impact on the whole MNC. The paper explores that ‘reverse diffusion’ played a positive part in the internationalisation process of these companies, although the impact on the home firms is limited. It has also been found that some new forms of the international learning are emerging in these Chinese MNCs. This suggests that diffusion in MNCs can be varied with different national and organisational characteristics.

INTRODUCTION

MNCs (multinational companies) are playing an innovation role in the globalisation of the world economy. In particular, they are seen as major vehicles for the dissemination or transfer of “best” management practice. Most research in this area has concerned MNCs from developed countries and how their home or HQ practices impact on HRM in their overseas operations. Generally, they adopt local practice only in response to legal or cultural constraints, or to operate in local markets, and have little interest in learning from it. In this context the transfer process is one of the forward diffusion of “best practice” from home to the subsidiaries. Less attention has been paid to MNCs from developing countries and their HRM strategy. This paper argues that MNCs from developing countries are not only obliged to localise their management practice when they operate in a country with an “advanced” economy, but may also use it as a means of acquiring the advanced management practice they need to compete in international markets. In this scenario, subsidiaries play a major role in organisational learning by absorbing “advanced” local practice and diffusing it back to the home firm in order to speed up their internationalisation process. Thus ‘reverse diffusion’ is seen as a means of knowledge acquisition for MNCs from countries relatively late to enter the global economy (Edwards and Ferner 2000, Ferner and Varul 1999).
In terms of Edwards (1998)’s definition, reverse diffusion is the process by which practice developed by foreign subsidiaries is captured by the centre of a firm, and diffused into other subsidiaries. Edwards and Ferner (2000) suggest that “reverse diffusion” is most likely used by MNCs whose subsidiaries operate in a country with advanced business and management environment. The subsidiaries absorb advanced practice and experience from the host environment, and then diffuse them back to the home firm. In this manner, the subsidiary becomes a source of innovation (Edwards, 1998) and plays a “vanguard” role in the process of change (Ferner and Value, 1999).

The degree to which MNCs from developing countries engage in reverse diffusion and the methods which they use to achieve it are largely unexplored. In this paper we attempt to gain a greater understanding of these processes through a study of Chinese MNCs operating in the UK. Chinese MNCs represent an interesting case from which to study the concept of reverse diffusion. Until the 1970s they operated in a domestic arena characterised by a centrally planned economy with little experience of competing in world markets. When the Chinese government adopted a policy of outward investment and encouraged participation in global markets they had a great deal to learn. Using practice and experience from economically advanced countries was regarded as a quick and direct way to internationalise (Young et al, 1995; Duan, 1996). In the 1980s, the Chinese government began to advocate using ‘international borrowings’ (jiejian) from Western countries as a means of promoting the modernisation of Chinese firms. The Government supported the process of knowledge acquisition in two ways. One was by encouraging foreign companies to invest in China in order to have access to their knowledge and experience. However, several authors have concluded that this process is constrained by the nature of Chinese institutions and cultures and foreign investment (Young et al, 1995). It is argued that the other method, “Walking out the Country Gate” is a more effective and direct way to learn international rules and experience (Duan 1995, Feng, 1995). Since the 1980s, China has had over 7000 non financial related companies operating internationally (People’s Daily, 12 September, 2003), opening up significant potential for learning from overseas subsidiaries.

Edwards and Ferner (2000) have argued that “reverse diffusion” is most likely to be found in MNCs operating in an economically advanced environment but add a number of other conditions. These include a high degree of business integration between the home firm and the subsidiary, and strong financial support and no short-term profit targets set by the home firm, thus giving resources and time to learn and diffuse. Even where such conditions may be present in Chinese MNCs, the degree to which reverse diffusion activities effect change in management practice in the Chinese parent companies is questionable. The difficulties experienced by foreign companies and joint venture’s attempts to introduce western practice are well documented (Warner, 2004, Gamble, 2003). To some extent these have been attributed to the problems foreigners have in penetrating the social networks (guanxi) that give access to people and resources that can get things done (Ahlstrom et al, 2000). Chinese companies are at an advantage in this respect, but established companies experience significant barriers to change posed by Chinese economic, social and political systems (Warner 2000; Child
and Tse 2001). The particular resistance of the state owned sector to modernisation, to which the largest MNCs belong, has been illustrated in a number of studies (Cooke 2004). Nonetheless, China has experienced rapid institutional change in the last decade through its open door policy, introduction of a market economy, a degree of decentralisation and privatisation, and some reform of the state owned industries. Such change has reduced economic differences between China and the advanced economies, and eroded some of the factors that have constrained the adoption of innovative practice in the past (Child and Tse 2001). However, the extent to which Chinese MNCs engage in reverse diffusion, and the impact on management practice in China, has yet to be empirically evaluated.

This paper reports on a study of Chinese MNCs operating in the UK in an attempt to answer this question. We start by explaining the methods used in the case study research, and then our findings. Finally, we return to the question of the extent to which reverse diffusion is a major characteristic of these Chinese MNCs, and conclude that while significant reverse diffusion activities take place, the extent to which it brings about significant changes in home practice is limited. We end by discussing the latest trends in “international borrowing” through which China is seeking to transform its home firms.

METHODS

In order to examine the diffusion activities, six organisations from the 24 Chinese companies in the UK were selected for in-depth case study. All were in the London area and are China’s leading and largest state-owned enterprises. Two are from the international trade sector which took the lead in setting up MNCs because of their long-term experience in international markets and with foreign clientele. The other four are from the financial sector, run by financial institutions such as the Bank of China. Thus, these companies not only play an important role in China’s trade and economic development, but also are main representatives of the Chinese MNCs internationalisation process. The six companies are all located in the London area which as an international financial and trading centre provides both the opportunity for and pressure on these Chinese companies to use and absorb advanced management practice.

Data collection was two stages: the first was from March, 1998 to January, 2000 and concentrated on the diffusion activities in the UK subsidiaries. In the second stage in May, 2002 and April, 2003 the parent companies or HQ of three of the companies in China were studied to find out the impact of the UK subsidiaries on the MNCs as a whole. The main sources of information were HR and corporate performance data, and some 200 in-depth interviews in the three parent companies and six subsidiaries. In the UK subsidiaries, interviews were conducted as part of a study of HRM strategy (see Zhang, 2001, 2003, Edwards and Zhang 2003). The interviewees included all top managers, most middle managers, and some senior staff who were involved the diffusion activities, both expatriates and locals. In the parent companies, interviews
were conducted with the top managers in charge of international HRM, and branch and departmental managers who had work or training experience in the UK subsidiaries.

MOTIVATION FOR DIFFUSION

Edwards and Ferner (2000) have argued that the MNCs most likely to undertake “reverse diffusion” have the following characteristics: (1) a demand for business integration between the home firm and the subsidiary; (2) the subsidiaries operate in an economically advanced environment. (3) strong financial support and no short-term profit targets set by the home firm (4) time to learn and diffuse. The Chinese MNCs studied largely conformed to this model. The main drivers in their case were that as state owned enterprises they had to comply with Chinese government internationalisation policy, and also deal with competitive pressure in the domestic markets which were gradually being opened up to foreign competition. These MNCs desperately needed the knowledge and experience of operating in a market-oriented economy in order to compete with international companies.

All the top managers interviewed in these subsidiaries claimed that learning western management practice is one of main purposes for which they were established or expanded in the UK. The government allowed them far more autonomy in doing business internationally than subsidiaries in other countries, and were given unprecedented latitude in the development of their management systems. In return they were expected to acquire market economy experience and to assist in the modernisation of the traditional Chinese management system in the state-owned companies. Newly established companies were allowed to adopt UK organisational structures and set up their organisations either via mergers with UK companies, or by using local managers in their design. Subsidiaries with a long history in the UK were permitted to place locals in managerial positions previously exclusively held by expatriates. The use of UK managers was extensive: in four of the six subsidiaries all middle managers were locals and 70% in the remaining two. While the migration of UK managers was less pronounced at senior level, in three companies, over 25% of top managers were from the UK. The overall effect was a significant degree of localisation of organisational structure, management systems and business procedures: 80% of Chinese and UK interviewed staff thought their company was more like a UK company than a Chinese one.

Other factors said to facilitate diffusion were also present: all six had a strong financial support from the State, and five out of six had no short-term pressure on profit-making, and, they had time to learn and diffuse. In addition these subsidiaries report directly to the parent companies, unlike subsidiaries in other countries that report to the regional HQ. As one of the chief executives explained, the parent company requires them to pass on their experience directly so that it can be adopted by the whole company.

With the possible exception of business integration which varied, it is clear that these Chinese MNCs have all the characteristics associated with the potential for reverse
diffusion. We would add to Edwards and Ferner’s (2000) list a high degree of localisation, a reporting structure that facilitates the transmission of information from subsidiaries and the home firm, and an owner (the Chinese state) intent on learning from their experience. It appears therefore, that these companies have both the motivation and the opportunity to engage in reverse diffusion. The extent to which they realise this potential is the question to which we now turn.

DIFFUSION ACTIVITIES IN THE SUBSIDIARIES

There was evidence of diffusion taking place in all six subsidiaries whereby practice developed was captured by the parent company, and passed on to other subsidiaries. This was achieved through a variety of cross-organisational learning activities:

All six companies take home firm senior and middle managers as trainees in the subsidiary. Local managers act as supervisors and mentors, passing on knowledge and experience. Trainees are also sent on external training courses, and given support for study to gain professional and educational qualifications such as the MBA, and Doctorates in Business Administration. The subsidiaries also provide formal training programmes, but this activity was most prevalent in one company that has its own training centre. They use UK experts to run training courses for home managers, and about 800 from the parent company and other subsidiaries have been trained so far. Most trainees are in senior managerial positions in the home firm, and 90% of the top managers of the parent company and main branches have been trained at the centre. The training courses are being extended to the departmental heads of main subsidiaries and branches.

UK managers are also sent to the parent companies to establish new practice and train staff in their use. For example, in one company, they go to the home firm every year to help set up systems similar to those in the UK. So far, 90% of middle managers have visited the equivalent departments in the parent company and other subsidiaries to help them establish new systems and to share their experience and expertise. The local manager in charge of the programme visits the parent company to train branch managers several times a year. The success of the exercise is such that his role has changed: “I go to the parent company four times a year. At first, I helped them set up the systems and trained the Chinese staff to use them. Now I go there and make regular checks to ensure they work correctly” he explained.

The assistance given by the UK managers can be substantial; one of the sample subsidiaries had been set up with the help of managers who were trained or had worked in the UK. It now transfers its management practices to other subsidiaries, including payment systems, performance appraisal and work organisation. In another company, the UK HR director was leaving to restructure an old subsidiary. He explained that all UK HRM practices and experience would be applied. These companies also play an active role in sending information about UK management practices to other subsidiaries. The managerial structure and work organisation in one case is regarded as a standard for other new subsidiaries as it was the place where HQ
used to be located, Even after HQ was moved to Hong Kong, the subsidiary is still regarded as the source of new and standard practices. Examples of their diffusion activities were observed during the fieldwork. During this time the author was asked to help them improve their appraisal system and run training courses. The activity was reported to HQ, and one week later, the HQ gathered all the details of the appraisal and the training programme and sent them to the other subsidiaries. The chief executive explained: “We have to do it because HQ keeps asking us for the practices here and then sends them other subsidiaries. We are used as an exemplar”.

Management meetings and visits play an important role in the diffusion process in all six companies. One company uses management meetings not only to introduce UK practice to the home firm, but also to diffuse “the best practices” they create in the subsidiaries. Of particular interest is their “UK management system mixed with Chinese management style” which constitutes UK performance and objective-led work organisation combined with Chinese “harmonious relations”. It has been introduced by their parent company through management meetings, and accounts in Chinese newspapers have spread their experience nationally.

In another example, international management experiences are diffused to the parent company through visits, management meetings and by passing on information. The chief executive described the process as follows:

“The parent company used to have no formal international management system. The expatriate management usually followed the domestic system, in particular of remuneration and assessment, which was low and egalitarian, and there were no links with performance and business objectives and profits. After this subsidiary’s success in business, we have been sending information about MNCs management here to the parent company through informal meetings with top managers in the parent company. The payment for expatriates has been changed to match international standards and will be related to performance”.

In addition to hosting managers from their own companies all six regularly accepted visitors from the Chinese government, and managers of Chinese firms. The main purpose was to provide an introduction to UK management practice and experience as well as explaining the operation of the subsidiary. In this way the six subsidiaries studied not only diffuse their experience within an MNC but also country-wide.

Even the company with the shortest operating experience in the UK plays an active role in diffusion activities which reach beyond the MNC to the wider Chinese business community. It holds a series of conferences on financial business and management for the Chinese financial sector. One of the top managers pointed out:

“As a subsidiary operating in a new area, which is also emerging in the domestic market, the managers in these organisations desperately need relevant UK practices and knowledge, and the relevant government departments ask us to take responsibility for it. So the conferences organised by us are open to relevant organisations all over
the country rather than just our parent company. We share all we have learned from here even though we have not used them in this subsidiary”.

Local managers play a key role in these diffusion activities. They attend and speak at the conferences to share information and knowledge about UK business and management with Chinese colleagues. In turn, they also have the opportunity to update their knowledge about the development of the Chinese business system. Diffusion very much depends on the expertise of UK managers who are used as vital sources of information, and as trainers, mentors, and supervisors.

Thus there is significant evidence of diffusion activities using a range of methods. The direct beneficiaries are primarily the parent company, and the other subsidiaries; but there are also indications of a wider diffusion process spreading beyond the home firm to the government and other state owned companies, and to the Chinese business community at large.

THE CHARACTERISTICS OF DIFFUSION

It appears therefore that diffusion is of a different order to that noted in by Ferner and Varul (1999) in German MNCs both in terms of is significance and origin. In that case, diffusion activity was relatively modest, initiated by the subsidiaries, and depended on business integration. In contrast, the amount of diffusion activity found in the Chinese MNCs was substantial, initiated and controlled by the parent company, and driven by the demands of central government. All the diffusion activities in the Chinese subsidiaries were arranged and financed directly by the parent company. For the subsidiaries, this role in training, development and disseminating western management practice were regarded as a central part of their job.

Secondly, the diffusion content is mostly home-related rather than internationally-related. The practices diffused by these subsidiaries are those most relevant to the reform agenda in the home firms and not necessarily based on practice that has been used successfully in the subsidiary. Managers, draw on many other sources of information to widen their understanding of UK management practice in general, and pass it on to the home firm. For example, one of the HR directors actively sought out the latest HRM practice: “I subscribe to all the UK’s HRM journals” he explained, “When I find some management approaches or practices that may be useful for the company, I cut them out and immediately send them back to home firm”.

Thirdly, unlike the diffusion mainly taking place within the MNCs studied by Edwards (1998) and Ferner and Varul (1999), there is significant direct lateral diffusion in addition to that channelled via the centre. Such diffusion activity takes place through a network of expatriates within the UK subsidiaries. As the six companies are state-owned, the expatriates meet at events arranged by the Chinese government in the UK. A network of all the top expatriates has developed from this regular contact. The network is informal, but they share a common interest in the fact that they are
government officials and their performance is assessed in comparison with each other. As one of the expatriates explained:

“We are all officers of the government. If compared to other subsidiaries here, your job has not been done well; you could feel big pressure. Then you have to learn how and what other subsidiaries have done. The network is one good channel to know and learn these things, and then you know which position you are in”.

The network also provides a channel to obtain information, including that on “best practice” in their sector. For example, when the appraisal systems were revised and training carried out for one company, its details were passed to all the executives of other companies in the network. One of the chief executives interviewed described this function of the expatriate management network:

“We are working in a new area and are supposed to provide “best practice” to home firms and other subsidiaries because we are in the UK. We do not get any advice on management from our parent company or other subsidiaries, thus, we have to use the expatriate network to exchange information on good experiences and lessons, and we learn from each other in our new businesses”.

The diffusion processes and mechanisms described were found in all the companies studied to a greater or lesser extent. Given that knowledge acquisition is an important mission for state-owned companies in China, this finding is not unexpected. However, there are variations. In well-established companies, for example, diffusion activities are more formal and follow top-down processes. In small and newly established companies, there is less diffusion activity, it is often informal, and sometimes bottom-up processes are used.

IMPACT OF DIFFUSION ON THE CHINESE MNCS

It is clear that the subsidiaries studied play a diffusion role. However, the extent to which these diffusion activities impact on the management practice in the MNCs as a whole was variable. There are some examples of widespread diffusion in companies with internationally-oriented business. In one for example, a UK manager helped to set up a quality control system in the parent company; now the system is used in over 100 subsidiaries at home and overseas. As a result, the entire company has achieved the first international quality standard in this area to be awarded in China. In another example, the chief executive of an international HQ acknowledged that the organisational structure and management system of his new international company was mostly copied from the UK subsidiary. Thus for these companies, reverse diffusion indeed helped them achieve the standards necessary to compete internationally.

In contrast, in companies mainly serving the Chinese domestic market, the impact is less evident. In the interviews with the branch managers of two companies in China, they acknowledged that some of the work and training experience they had gained in the UK has been applied in their companies. For example, they mentioned the
introduction of UK type work systems, HR recruitment and assessment processes, and methods of motivating people, especially how to assess performance and make staff work efficiently. However, these respondents perceived the impact on the home firm to be limited. There are two main reasons which were apparent from the interviews:

Firstly, some practice does not fit the home environment. For example, facing a huge amount of surplus labour, the recruitment process used in the UK is only adopted by these companies as a developmental exercise. In practice, the surplus of labour supply over demand is such that there are unmanageable numbers of applicants for each post and selection is made on the basis of personal contacts rather than a formalised recruitment process. As one manager admitted:

“We did use a recruitment process which is similar to the one I learnt in the UK, but before the interviews the candidates for most posts have been decided already. For the positions which are above the middle managerial level, it is still decided by the government rather than from the labour market or organisation”.

As the home firms are state-owned companies directly controlled by the government, the policies and practice employed have to be approved by central government. The system imposed has yet to be changed to incorporate market-oriented practices, and the subsidiary’s experience could not be used. Moreover, the subsidiary is relatively small and in a new business area, and the experience, particularly in HRM, does not fit the large size, and domestic market oriented business of the home firm. These Chinese MNCs are large with over 10,000 employees and more than 100 branches and the state-owned sector has a very strong traditional management culture. These two factors combined with entrenched power positions at the top makes them particularly difficult to change. Thus, the experience of the UK subsidiaries is not strong enough to make a significant impact.

Secondly, since the late 1990s, the subsidiaries have had more pressure from the parent companies to reach profit targets owing to losses in the home market. Thus, they have had less financial support from the parent companies and have to focus on their own operations in the UK. Most are struggling to survive in the UK environment, and there is less time to engage in diffusion. One top manager in charge of international business commented:

“This is for the subsidiary, the first thing is to survive, and then they will have something to say to the home firm and other branches”.

Owing to these constraints the companies are considering a different approach to international learning. One is to recruit expertise overseas to replace home managers at the top level. The intention is to use foreign managers to eradicate the current management system and network, and to develop a new system from the top. Two companies have recruited foreign managers at the top level with such a remit.
Another method avoids the problems of changing established companies by asking overseas subsidiaries to set up new branches in China. The UK subsidiaries of two companies have already set up their own subsidiaries back in China with a UK management structure and practice. When asked why they did not use one of home firms, a top manager of one of the companies explained:

“The whole financial system and structure in China has not been changed yet, and applying UK structures and practices to old organisations in the home firm is still difficult. Thus, we build up new branches which are less influenced by the old system so that it is easier to use UK management practice”.

The chief executive in another company explained, “The business we are doing here is totally new to the home firm. So we have to develop our own subsidiaries to apply it. Now this subsidiary has become the HQ of this new business. In their subsidiaries, the management system is totally led by international business demands rather than anything else”.

Another overseas HQ is planning to exploit the Chinese government’s special policies for foreign investment and send their subsidiaries into China as a foreign company. Currently, they are recruiting more foreign experts to advance their international management. They also are recruiting graduates from UK universities with some Chinese background into their overseas companies. They will work in overseas companies for the next five years then go to China to establish new branches supported by the government’s subsidy for foreign investment. At that time, they will compete with the home firm. The long term strategy is to establish branches unconstrained by the heritage of the parent company and eventually to replace the home firm in China’ markets. Then they will use the advantage of home-base knowledge and resources to compete with foreign companies in China.

Thus while the need for “international borrowing” remains, the methods for acquiring such knowledge are changing. In the case of the two major state owned companies studied, the focus is on a form of inward investment: bringing overseas experts and systems into China itself, as well as using overseas subsidiaries as an information source and training ground for managers.

CONCLUSION

At the start of this paper we raised a number of questions about the potential for reverse diffusion in Chinese MNCs in the UK. In many respects they present many of the characteristics said to facilitate reverse diffusion. As state owned companies the policy of reverse diffusion was not only closely aligned to corporate strategy, but also financially supported and directed by the State. The UK is an advanced economic environment that offers unparalleled opportunities to absorb the knowledge needed to progress their internationalisation process, and, owing to extreme cultural difference, there is also pressure to localise management practice. Initially set up without short term profit targets, they had the time, resources and incentive to adopt the latest UK
practice and engage in diffusion activities. The subsidiaries therefore were well placed to absorb and transfer business and management knowledge to the home firm and other international subsidiaries. The study identified a range of diffusion activities including accepting home firm management training in the UK subsidiaries, running training programmes, conferences and meetings that introduced western “best practice, and assisting in setting up new management systems in other subsidiaries and at home. In this sense, the subsidiaries played a vanguard role in the Chinese MNCs’ internationalisation. Reverse diffusion was a strategic consideration and a formal process of considerable significance for all six of the subsidiaries studied.

The central role of diffusion and its extent in the Chinese MNCs is very different from the findings of other studies. In the cases researched by Edwards (1998) and Coller (1999), there was far less diffusion activity and it was far less strategic, more tactical and pragmatic. Moreover, in Chinese companies, the diffusion activities are initiated and directed by the home firm. The subsidiaries captured the new practices and then sent them back to the parent company in China. There was also evidence of lateral diffusion through an informal subsidiary network, and to the Chinese business community beyond the MNCs. In the German companies described by Ferner and Varul (1999), diffusion activities there mostly started from the subsidiaries and captured by the HQ, and then diffused to other subsidiaries or the home firms. This finding would support Ferner and Varul’s (1999) conclusion that reverse diffusion does not necessarily signify a process of homogenisation and convergence among national models.

Despite the amount and extent of reverse diffusion, and its strategic priority as part of the Chinese State’s internationalisation policy, our initial research suggests that it has not made a significant impact on the home firms. The MNCs studied are typical of the large State Owned Enterprises in which the “organisational inertia” noted by Warner (2000) and Ding and Attar (2004) persists. The strong traditions of management have proved resilient in the face of modernisation, and there are also arguments that management practices derived from the experiences of small scale subsidiaries operating in an environment with such great institutional and cultural difference are not relevant to China at this stage. This may also support the Edwards’ argument that the reverse diffusion depends on international integration.

The fact that some Chinese MNCs are seeking new strategies in their attempts to internationalise their operations, suggests that reverse diffusion is only one form of international learning in global integration. Chinese MNCs deliberately used “reverse diffusion” as a main form of their international borrowings in the earlier stage of internationalisation. Reverse diffusion provided knowledge of how to manage in a market economy for the parent company. However, the impact of reverse diffusion on the home firm is limited owing to lack of international business integration, and a home environment that, despite change, does not provide the necessary support for advanced management practice. In the face of continued resistance to modernisation, new forms of international learning are emerging in Chinese MNCs’ internationalisation strategy. More direct methods of importing western expertise and
management systems are being contemplated. The employment of overseas trained managers to head up the parent companies, and the prospect of setting up of branches of UK subsidiaries in China to directly compete with the existing home firms are of a different and more radical order than the transmission of practice observed in this study. All this suggests that the diffusion of new practice in MNCs will vary.

References


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