Challenges for foreign companies in China:

Implications for research and practice

Introduction

In November 1971, the Times magazine marked its cover page with "The Chinese Are Coming", but back then, few would have expected the Chinese to have come quite so far by today. Within five decades, China has undergone an economic miracle, rising from one of the least developed countries to the second largest economy in the world. In 2018, the GDP of China was about 13.46 trillion U.S dollars with 6.6 annual percentage growth (IMF, 2018), ranking between the U.S and Japan. Although the estimated GDP growth rate for 2019 is expected to slow down to 6.2 per cent (IMF, 2018), this growth rate still indicates massive economic expansion.

As a large country with great development potential, China has attracted enormous foreign direct investments (FDI). It has been one of the most popular foreign direct investment destinations since initiating its economic reforms (Wu & Burge, 2018; Zhang et al., 2016b). While in the 1980s domestic investment was central, FDI became much more important over the 1990s, and increasingly has contributed to China's overall economic growth (Wu & Burge, 2018). By the end of 2017, 136,997 foreign-invested companies were registered in China (NBSC, 2018). In 2018 alone, 60,533 foreign-invested enterprises were newly established, and 134.97 billion U.S dollars of foreign capital was spent in China (MOFCOM, 2019), among which the U.K and Germany were distinct with 150.1% and 79.3% annual investment increases respectively (MOFCOM, 2019). Foreign companies have been and will continue to be important actors in the Chinese market.

There are many opportunities that foreign companies can take advantage of, including various investor-friendly policies in the special economic zones (Wu & Burge, 2018), improved quality of human resources (Ma, Silva, Callan, & Trigo, 2016) and better infrastructure and so forth. Recent developmental figures illustrate an optimistic future. In 2017, China invested 12.59 billion U.S dollars in transportation infrastructure, 3.02 billion in energy and 1.43 billion in water, roughly equal to 4, 2 and 29 times to India respectively (World Bank, 2019). Such impressive investments promise a better developed industrial society which is a good foundation for further business developments. Nevertheless, the most attractive part of China is probably the sheer market size. Thanks to the 1.4 billion population, China has been the largest market for many products. In 2017, Volkswagen sold 41.58% of its passenger cars in the Chinese market (Volkswagen, 2017), and many other giant multinational enterprises (MNEs) such as Nestlé and L'Oréal also reported their highest growth in China compared to other regions. Moreover, China can provide a good environment for exciting new business possibilities in the domestic market as a digitally advanced country. The thriving digitalization in China offers opportunities for foreign companies to break the fences and penetrate the market or access resources with new business models. L'Oréal took the chance and evaluated its digital sales with "very good e-commerce results" (L'Oréal, 2017, p. 51).

Despite these opportunities, foreign companies increasingly face a variety of challenges especially during the "soft-landing" of the Chinese economy. Perhaps due to the clear signals in 2018 of the anti-globalization tendency, the IMF forecasts decrease of main economic factors for the following years, not only in China but also in many other major economic entities (IMF, 2018). The increasingly unfavorable international environment will have significant influences on foreign companies in China, such as causing fiercer competition from local companies who shift back to the domestic market. Another notable disadvantage that foreign companies cannot ignore is the liability of being outsiders. A very recent example was the backlash against the Italian luxury brand Dolce & Gabbana in China after it launched an advertisement with unflattering stereotypes. The founders of the brand apologized for delivering offensive messages due to “cultural misunderstandings” (BBC, 2018), again confirming the importance of gaining local knowledge.

Doing business in a foreign country is not an easy task, and the dynamic Chinese market contributes to an even more challenging environment. Despite its impressive economic development, China is still a transitional economy, as it is arguably still moving from a position were few market supporting institutions existed (i.e. a centrally planned economy). Thus, it may still be problematic to apply management approaches from advanced Western countries in China (Warner, 2009; Zhao & Du, 2012). This calls for more novel and contextualized research. Based on a review of the extant literature, this paper provides an overview of key challenges for foreign companies in China, and provides directions for future research and business practice. Building on international business (IB) research and recent business developments in China, we focus on two key challenges related to the business environment, namely, regulatory and cultural challenges, and two key management challenges, namely, innovation and human resource management.

Regulatory challenges

Foreign businesses in China face government, legal and regulatory challenges on two main fronts. Firstly, China is an emerging market, characterized by a comparatively weak and fast evolving judicial and regulatory institutional environment. There is great flux in regulatory change across a broad range of spheres, including: environmental regulation and pollution prevention (He, Xu, Pang, Tian, & Wu, 2016); capital/financial sector regulation (Zhang, Cai, Dickinson, & Kutan, 2016a); housing and real estate regulation (Glaeser, Huang, Ma, & Shleifer, 2017); labour markets (Chang & Cooke, 2015); and digital media content (Han, 2016). Related government procedures, moreover, are generally less transparent. This can mean that standard everyday tasks, like obtaining permit and product approvals, for example, may potentially become a drain on management resources.

Secondly, and arguably of far greater importance owing to their asymmetric impacts, local and central level actors can potentially exploit local institutional fragility and regulatory flux to preferentially favour and support domestic firms. Indeed, China has long espoused ambitious domestic industrial policies to nurture national champions (Sutherland, 2003). The policy to build a ‘national team’ of around one hundred large internationally competitive business groups, for example, follows an East Asian model of development (particularly Japan and South Korea, with their large *keiretsu* and *chaebol* groups). This Chinese development strategy actually dates back to the early 1980s (Guest & Sutherland, 2009). Its evolution over four decades is now reaching its zenith. The current China ‘Manufacturing 2025’ policies, for example, target ten specific industries (including new advanced information technology, automated machine tools and robotics, aerospace and aeronautical equipment, maritime equipment and high-tech shipping, modern rail- transport equipment, new-energy vehicles and equipment, power equipment, agricultural equipment; new materials; and biopharma and advanced medical products). In areas such as new electric vehicles and battery technology, semiconductors, solar panels/modules and wind power, interventions have been extensive, ongoing and highly prominent (World Bank & DRC, 2013).[1]

One of the greatest geopolitical issues of our day, the China-US relationship, is intimately tied to these ongoing industrial policies. Ongoing trade negotiations in early 2019, for example, centered on Chinese state subsidies, government directed credit (via the state-controlled banking system) and public procurement, as well as forced technology transfer. In

[1] Semiconductors, for example, are reported to have received over $150 billion in government subsidies alone. According to the US President’s Council of Advisors on Science and Technology, Chinese industrial policies in this sector "‘pose real threats to semiconductor innovation and US national security"’ (Lucas 16/01/2017). New battery technologies have similarly received great support, with large state-owned groups like CATL now emerging as one of the largest players on the world stage (Sanderson, Hancock, and Lewis 05/03/2017). Similarly, support (and overcapacity) in wind and solar- power sectors have been prominent to date.

short, China appears to be using domestic legal, regulatory and government interventions to favor its domestic firms. Policy-makers, moreover, appear unlikely to deviate from their current commitment to state orchestrated capitalism (currently only “cosmetic, non-impactful offers” on Chinese subsidies have been made, for example, and current negotiations with China have been likened by US negotiators to “pulling teeth” owing to China’s “stonewalling on market access”). Similar to the US, sentiment in the European Union has swung strongly against Chinese interventions. KUKA’s acquisition by Midea Group in 2016 sparked a national debate within Germany and a significant change, led by Angela Merkel, in the mindset of European Union leaders. Greater reciprocity from China (i.e. market access, fewer institutional and regulatory blocks on foreign MNEs) has become a key issue, as has a strategic response from Europe. Recent EU attempts led by France and Germany, for example, to create a European champion in train-making (and engage with China using similar strategic approaches) have been launched. These, however, have so far failed. Attempts in early 2019 to merge the train manufacturing operations of Alstom (France) and Siemens (Germany) as a response to Chinese industrial support for CRRC (the biggest train maker in the world) were blocked by the EU competition commission., The commission head (Margarethe Vestager), has acknowledged that it is “more and more obvious” the market openness between the EU and China is “an asymmetrical thing” (Toplensky, n.d.). European leaders are now looking to reform competition rules to create a system that may be more in line with strategic industrial policy (i.e. China’s state capitalism model is drawing a strategic response from Europe). Current geopolitical interactions between the US, EU and China testify to deep concerns about asymmetric industrial interventions that China has engaged in to facilitate firm-level catch-up.

All firms face and may equally respond to domestic institutional voids. While these are interesting to understand, arguably of greater interest today is the question of how Chinese state industrial policies and government intervention interact with the legal and regulatory environment to give domestic big business a leg-up over foreign rivals. To what extent do such policies actually discriminate against foreign competitors in China, putting them at a disadvantage? How effective, if at all, is current Chinese industrial policy to force technology transfer? Why might China be in a good position to orchestrate such a strategy? Do particular industries, like renewables, a recipient of *Manufacturing 2025*, more strongly benefit from these policies or are they more widely diffused? In short, how justified are European and US policy-makers in making their current claims against China? To answer these questions, more detailed industry level studies are required.

Cultural challenges

China has a long history of over 5,000 years, and Chinese culture has had a profound influence on Asia. Traditionally, under the influence of Confucian, Taoist and Buddhist faiths, Chinese culture has generated a rich and profound system of values (Leung, 2010), and these values have been uniquely evolved in each region/municipality of China (Kwon, 2012). Culture can be defined as distinguished values, norms, behaviors, rules, and psychological and systematic assumptions among groups of people (Hofstede, 1991). IB has been all about the operational business in the global arena, where different cultures among groups of people can conflict or melt down each other. However, before Hofstede's (1980) seminal study on work-related values employing data based on employee attitude surveys from 88,000 employees of IBM subunits in forty countries, there was no appropriate cultural index that could be studied by IB scholars. However, after Hofstede's four cultural dimensions proclaimed, and later Kogut and Singh (1988) created a cultural distance index, providing the first measure of cultural differences between countries, there has been a *quantum leap* and flourishing of IB studies based on Hofstede's and Kogut and Singh's pioneering works. Since then, IB scholars have researched international activities across countries with different cultures which can influence directly and indirectly MNEs' critical decision-making, headquarters resource allocation, global network and embeddedness relationship, and organizational performance (e.g. Ambos & Ambos, 2009; Dellestrand & Kappen, 2012; Zeng, Shenkar, Lee, & Song, 2013).

While IB scholars have mainly studied cultural phenomena in the context of national cultural dissimilarities between home and host countries, there has been limited spotlight on subnational cultural dissimilarities within countries, and China specifically (e.g. Kwon, 2012; Ma, Delios, & Lau, 2013a; Ma, Tong, & Fitza, 2013b; Tung, Worm, & Fang, 2008). Tung (2008, p. 41) even emphasizes that "[g]iven the growing diversity of workforce within a country, intra-national variations can often be as significant as cross-national differences." Recently, the number of limited studies on within-country cultures or cultural differences has been increased. To empirically explore the work values of employees in China, Kwon (2012) applies Hofstede's national cultural dimensions to measurements of subnational cultural ones within mainland China. Kwon finds there are differences of some subnational cultures between Shenzhen (a southern region of China) and Taiyuan (a middle region of China). Ma et al. (2013b) report that, in China, within-country dissimilarities are linked with foreign subsidiary outcome differentials. However, the problem of the previous studies on national and subnational cultural differences is that they did not investigate the interplay between national and subnational cultural differences, particularly, when foreign MNEs operate in China. A very recent study contributes to culture related literature by emphasizing cultural differences at both the within- and cross-country levels concurrently affect headquarters resource allocations for innovation transfer between sending and receiving subsidiaries in China (Miao, Zeng, & Lee, 2016).

To date, limited studies have approached to identify the effects of within-country and/or cross-country cultural differences on various factors particularly in China. Comparative cultural studies between China and other country(-ies) (e.g. India) can be meaningful in future research. By doing this comparison, future research can obtain generalizability. Also, when investigating subnational cultures, scholars may expand their understanding by using other cultural frameworks such as the GLOBE study (House, Hanges, Javidan, Dorfman, & Gupta, 2004), Ingelhart and associates' World Value Survey (1997), the Schwartz Values Survey (1994), etc. Finally, these within-country and cross-country cultural differences can affect subsidiary staffing and cultural friction in local subsidiaries of foreign companies in China; thus, accordingly this research should be fulfilled in future studies (Singh, Pattnaik, Lee, & Gaur, 2019).

Innovation management challenges

Innovation management in China is an important topic for both foreign firms and domestic stakeholders. It has been manifested largely through collaborative partnerships between foreign firms and domestic ones (Collinson & Liu, 2019) in the form of joint ventures (Zhou & Li, 2008) in the last four decades. In the form of international partnerships, learning from collaboration partners (Tsang, 2002) can contribute to capacity building and industry upgrading (Herrigel, Wittke, & Voskamp, 2013). Despite joint venture helped China to accumulate knowledge, gain experience and develop innovation capabilities (Zhao & Anand, 2013), foreign partners largely prefer not sharing the core of innovation with Chinese domestic partners, partially due to the lack of intellectual property rights protection. Furthermore, when regulatory frameworks allowed, joint ventures tend to be converted into foreign wholly-owned subsidiary in China (Puck, Holtbrügge, & Mohr, 2009). In this way, foreign firms may develop and protect innovation within organizational boundaries. In addition, China's rapid economic development demands the transformation from "Made in

China” to “Created in China”, in order to move up the global value chain in global competition. Importantly, China’s innovation challenge is to overcome the middle-income trap to become an innovation economy (Lewin, Kenney, & Murmann, 2016).

Two emergent approaches in relation to innovation management have attracted significant attention in both scholarly inquiry and public policy initiatives, namely (1) Chinese cross-border mergers and acquisitions (M&A) for innovation and technological upgrading; (2) overseas high-skilled talent returning to China. First, Chinese firms responded to the national “Go Abroad” strategy via M&A in the pursuit of acquiring advanced technology (Liu & Woywode, 2013). This still nascent phenomenon put challenges to Chinese acquirers, because they may not possess the necessary absorptive capability or lack understanding of the institutional arrangement in host countries in managing strategic assets, such as brand (Liu, Öberg, Tarba, & Xing, 2018). In China’s globalization endeavors, one key motivation is learning. But the effective innovation management and knowledge transfer requires boundary spanners with pertinent experience and ability (Liu & Meyer, 2018). In other words, human side psychological micro-foundations can significantly affect innovation management in collaborative partnerships between foreign firms and their Chinese counterparts (Liu, Sarala, Xing, & Cooper, 2017). Second, overseas high-skilled talent returning to China became a national strategy (Wang & Liu, 2016). Not only can returnees start their own entrepreneurial and innovative ventures (Liu & Almor, 2016), but they can also join research institutions or universities and foreign firms in China to upgrade their research capacities (Zhang, Patton, & Kenney, 2013). Returnees may contribute to innovation and entrepreneurship on organizational-level (Liu, 2017) and regional-level (Xing, Liu, & Cooper, 2018). Notably, returnees can even compensate the lack of university capability in China to foster innovation and regional entrepreneurship (Liu & Huang, 2018). The presence of foreign firms and their interaction with returnee and domestic firms can contribute to innovation management.

In linking the global strategy and innovation management domain, we argue emerging economies may offer the experimental lab to cultivate new innovative ideas while addressing the global challenges faced by both foreign firms and domestic counterparts. For instance, reverse innovation may benefit both China and the rest of the world by delivering ‘value for many’ besides ‘value for money’ (Govindarajan & Ramamurti, 2011). The rapid deployment of technological advancement, such as Artificial Intelligence and Big Data in the age of digital economy, provide opportunities for both Chinese and foreign firms to transform and innovate (Zeng, 2018). We suggest China may lead innovation, even break-through innovation given the strong commitment from governments, foreign firms need to rethink their innovation strategy in order to succeed in this dynamic digital economy (Li, 2019). Nevertheless, China and the rest of the world hold the shared destiny together and innovation in China will bring co-prosperity for the world. Collaboration and cooperation will be the way forward.

Human resource management challenges

Along with the development of the Chinese economy, HRM has become an increasingly important topic in China. Foreign capital brought modern HRM into the Chinese market, leveraging from foreign-owned enterprises (FOEs) to joint ventures (JVs) and further to large domestic companies (Warner, 2009). Foreign companies introduced formalized high-performance HR practices, which have been attractive to Chinese employees (Ma et al., 2016; Zhang et al., 2016b). The transitional Chinese employment system gradually changes from capital-oriented to talent-oriented (Zhao & Du, 2012) after several decades of industrialisation. Chinese HRM system is a hybrid model (Ma et al., 2016) with an “ongoing process of paradoxical integration” (Warner, 2009, p. 2183). There are theoretical and practical necessities to develop intensive research in HRM responding to up-to-date Chinese mechanisms of economic and social transition (Zhao & Du, 2012).

Attracting and retaining highly qualified personnel has been of the main challenges for foreign companies in China (Dewhurst, Pettigrew & Srinivasan, 2012; Hitotsuyanagi-Hansel, Froese, & Pak, 2016; Ma et al., 2016; Zhang et al., 2016b). While the number of college graduates is abundant, more than seven millions students graduated in 2017, the number of highly qualified talent sought by foreign firms, particularly at higher managerial levels remain scarce (Han & Froese, 2010). In consequence, highly qualified talent can demand high pay and can easily switch jobs, resulting in high employee turnover rates (Dewhurst et al., 2012; Han & Froese, 2010; Zhang et al., 2016b). This is costly for foreign companies. Although foreign companies offer desirable jobs with higher pay (Wu & Burge, 2018), Chinese talents in the new era require more than high pay, including career opportunities, training opportunities, and job autonomy (Froese, 2013; Froese & Xiao, 2012). Meanwhile, Chinese domestic companies have imitated the HRM system of foreign companies and become attractive employers (Dewhurst et al., 2012). While foreign companies relied on expatriates in the past (Han & Froese, 2010), Western expatriates are less willing to move to China (Dewhurst et al., 2012), making it even more difficult for foreign companies to attract talent. While foreign companies struggle, due to country of origin effects (Froese & Kishi, 2013; Zhang et al., 2016b), Western companies may have fewer difficulties compared to their Asian counterparts (Froese & Kishi, 2013). More research is needed to better understand how foreign companies can become more attractive to Chinese job candidates and retain them.

Increasing diversity is another emerging challenge for domestic and foreign companies alike. The demographic characteristics of Chinese domestic labor force are changing. China is rapidly going into an ageing society. The Chinese fertility rate is 1.624 child per women in 2016 (Word Bank, 2019), far below the conventional replacement fertility rate (approximately

2.1). Most existing HRM research with Chinese context focus on relatively young generation. Given substantial value differences between generations in China (Froese, 2009), little is known how companies can manage an age-diverse group of employees. Another diversity challenge comes from the endogenous complexity of the Chinese labor market. Regional unbalance is a notable characteristic of Chinese HRM practices (Zhao & Du, 2012). Giving the fact that current foreign companies agglomerate in certain regions (NBSC, 2018), it will be theoretically and practically interesting to discover more relationship between the diverse regional conditions and the effectiveness of HRM in foreign companies. Meanwhile, within foreign companies, their expatriated talents also become diverse. The rise of non-traditional expatriates in China (Kang, Shen & Benson, 2017) suggests challenges of supporting such flexible human allocation strategies in foreign companies (Kang et al., 2017). Apart from international mobility, internal mobility of Chinese workers would be an important issue.

Conclusion

While China is an attractive market for foreign firms, our review reveals key challenges of doing business in China. Table 1 provides a summary of key challenges and implications for research and practice.

(Please insert Figure 1 around here)

First, the business environment in China has become increasing challenging for foreign MNEs in recent years. Chinese regulatory institutional environment involves a flux across a broad range of areas (i.e. Chang & Cooke, 2015; Glaeser et al., 2017; Han, 2016; He et al., 2016; Zhang et al., 2016a;). The Chinese legislative system lacks transparency, and favors domestic firms, particularly in some high-tech related industries such as renewable energy or robotics (Sutherland, 2003). Many current geopolitical conflicts between China-US/EU are related to such asymmetrical industrial policies. Thus, more research is needed to better understand the causes and consequences of the changing industrial policies. Foreign MNEs are advised to invest in human resources and political connections to influence policies and/or find ways to deal with new policies.

The cultural environment is also critical factor complicating business for foreign firms in China. Although many scholars have researched cultural differences (e.g. Froese, 2013; Hofstede, 1980; House et al., 2004) and the role of cultures on influencing MNEs (e.g. Ambos & Ambos, 2009; Dellestrand & Kappen, 2012; Zeng et al., 2013), within-country cultural dissimilarities are relatively less discussed (Tung, 2008). Given the cultural and regional complexity in China (Kwon, 2012; Leung, 2019), it is not surprising to find subnational cultural differences within the country (e.g. Kwon, 2012; Ma et al., 2013b). Future research is encouraged to investigate the influence of within-country and cross-country cultural differences on leadership, staffing, and strategic management of foreign subsidiaries in China. In addition to localization (Bader et al., 2017; Hitotsuyanagi-Hansel, 2016), foreign MNEs are advised to consider regional differences in their staffing strategies in China.

Second, foreign firms in China also come across significant management challenges. Notably, innovation management can be one of the major challenges. Whereas China used to absorb knowledge from foreign MNEs through international collaborations (Collinson & Liu, 2019; Herrigel et al., 2013; Tsang, 2002; Zhao, 2013), it now encourages homegrown innovation through launching international M&A and attracting high-skilled returnees. Consequently, foreign MNEs need to consider the new aspects of innovation management, such as micro-foundations in collaborative relationships with Chinese partners or the presence of indigenous innovation. As an emerging economy with abundant resources, China may lead innovation in the digital era. Foreign MNEs may want to learn from China via collaborations with local partners and setting up R&D centers in China. More research is needed to better understand how foreign MNEs can learn from foreign subsidiaries though coopetition and innovation in China.

HRM has been one of the top management challenges for foreign MNEs. Foreign companies have difficulties in attracting and retaining highly qualified talent in China (Dewhurst et al., 2012; Han & Froese, 2010; Ma et al., 2016; Zhang et al., 2016b). The situation is likely to continue, if not worsen, in the following years due to declining demography. Changing demography and regional differences are about to bring more diversity into the workforce. Already being used to it, MNEs from Western industrialized countries might be in a better position to manage diversity (Bader, Kemper, Froese; 2019; Kemper, Bader, Froese, 2016, 2019). Chinese companies might learn from Western MNEs how to deal with an increasingly diverse workforce (Kemper et al., 2019). Foreign MNEs are advised to better understand the needs of Chinese talent and accordingly modify their HRM to attract and retain them (Froese, 2013). Given the complex and unique characteristics, more research is needed to better understand talent management in China.

In summary, China presents great opportunities but also major challenges for foreign MNEs to do business. In this article, we have reviewed key challenges, possible managerial counter strategies, and identified avenues for future research. To be successful in China it is essential for foreign MNEs to understand the unique business environment and gain legitimacy. To achieve these goals, foreign MNEs are encouraged to engage with the local environment, hire local talent and nurture important connections.

Table 1: Summary of challenges and implications

	Key challenges	Managerial implications	Future research directions
Regulatory environment	Understanding flux in regulatory regimes across a broad range of areas; recognizing where judicial/regulatory systems are asymmetrically used against foreign MNEs	Stay on top of evolution in local regulatory environmnet (i.e. invest in local human resources and political connections); acknowledge that in some circumstances such investments may not be justified (i.e. in strategic industries/areas where asymmetric support is given to local actors); engage in business councils/coalitions to influence high level policy-making	Extent of asymmetric interventions and Chinese industrial policy; industry level studies to explore finer details (i.e. China 2025, internationalisation and growth of renewables sector, robotics, artificial intelligence etc.); nature and impacts of strategic interventions; impact of geopolitical situation on the evolution in regulatory/institutional environment in light of current trade/investment disputes.
Cultural environment	Within-country cultural differences	Hire local personnel who can understand subnational cultures in China	Effective cultural leadership and handling within-country cultural conflict in China
	Cross-country cultural differences	Leverage efficient subsidiary staffing and reduce the friction between expatriates and host country nationals	Subsidiary staffing, cross-country cultural friction, and subsidiary survival/exit in the Chinese context
Innovation management	Select and collaborate with right partners (e.g. government, universities and firms)	Work with local organizations with appropriate capabilities and recruit returnees as boundary spanner	Coopetition and innovation Innovation to address global challenges Innovation and intellectual

			property rights protection
	Understand the dynamic and fast changing environment	Set up R&D centers (wholly-owned, or through partnership) in China to gain deeper understanding of the Chinese market and consumer behaviors	Implication of global value chain and (anti)globalization for innovation Capturing the benefits from indigenous innovation for global markets
Human resource management	Attracting and retaining talent	Offer developmental and career opportunities	Recruitment and retention research considering unique Chinese aspects
	Increasing diversity	Manage diversity	Generational differences; internal migration; expatriate-host country national interactions

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