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CHINA: MANAGEMENT IN TIME OF CHANGE

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Summary

*The West's fascination with China, and particularly with recent economic and social developments in the People's Republic, remains intense. Some of the most fascinating changes are currently taking place in the way managers are seizing their new-found autonomy. This article examines the position as it was identified during a study visit in the Summer of 1987.**

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It is unnecessary to go into the details of China's history during this century, or even since the Communist Party gained power in 1949, to emphasise the turbulence and change in the recent past of this massive country. Readers will be aware of the background of Five Year Plans, the Great Leap Forward and the Cultural Revolution. Each of these developments had a major impact on the management of enterprises in the economy.

The last decade, and in particular the last few years which are the focus of this article, have continued this process of rapid change in Chinese society in general. The management of enterprises, especially, has changed markedly in recent years.

The developments in the years since the death of Mao Zedong in September 1976 have been ones of considerable debate about the ways in which the economy should be organised. They have also seen the development of new approaches and very significant success.

A key turning point occurred in December 1978, at the 3rd Plenary Session of the 11th Central Committee of the Communist Party of China (CPC). A series of policies were endorsed covering:

- reform of the economic structure, in particular through reducing centralisation;
- readjustment of the national economy to overcome imbalance and dislocation;
- development of agriculture to overcome previous neglect;
- development of Party rules and regulations to limit the tendency to focus decision-making entirely on Party officials; but at the same time
- development of the accountability of local officials to the centre; and
- strengthening and legalising socialist democracy

These policies were the base for a series of reforms advocated by the pragmatists in the Party led by Deng Xiaoping. They were developed in the following years by the institution of the Special Economic Zones (SEZs) in July 1979 and April 1984 and by the decision to open up the Chinese economy to foreign trade and foreign investment.

The programme was summarised in the 'Four Modernisations' (industry, agriculture, national defence and science and technology) formally propounded in September 1982.

The period between 1979 and 1984 was largely one of isolated experimentation. There were experiments in reduced central control in the SEZs; experiments in liaison with foreign companies; experiments with the trade unions and workers' congresses (1).

This process was formalised, unified and extended in 1984. At the 2nd session of the 6th National People's Congress in May and the 3rd Plenary Session of the 12th Central Committee of the CPC in October the lessons of these experiments were analysed and debated. The Central Committee adopted a Decision on the Reform of the Economic Structure. This created a major national programme which has had a very marked effect on the Chinese economy (2).

The 1979 changes, perhaps because they involved foreign companies, have been much more widely discussed in the Western literature than the 1986 reforms. There is little doubt however that it is the latter which are having the most significant effect on the management of enterprises within China.

The 1984 policies are objectives, to be introduced as appropriate in particular situations. Their overall effect is to extend considerably the autonomy of the management in the enterprises. Managers in these areas can achieve levels of authority and accountability very similar to those enjoyed by managers in public enterprises in the West. Many already set their own production or service targets, negotiate with suppliers, adjust prices and retain and distribute profits. A number of enterprise managers have expanded their operation vertically, making Marks and Spencer or Benetton type arrangements with suppliers, or bringing their own products directly to the market. We examine below the operation of these new policies.

The 13th Communist Party Congress held in Beijing at the end of October 1987 consolidated the reforms. The election of Zhao Ziyang as leader to follow Deng, with a largely supportive group elected to the Standing Committee of the Politburo, marks a clear commitment to the new line. The keynote of Zhao's speech to the Congress was "accelerate and deepen the reform".

Two preliminary points should be made about the reforms. Firstly, they do not mean that China is becoming capitalist. It is still an avowedly socialist society. Gao Shangquan, deputy director of the state councils economic restructuring committee expressed it neatly: "The State will regulate the market, and the market will guide the economic activity of the enterprises" (3). Secondly, the aspects of Dengism that is unique to recent Chinese history is its pragmatic and experimental character. Reforms will be tested and tried: spread if they work and abandoned where they do not.

Where they have been most completely adopted the reforms have given managers a new motivation and greater independence. This has led to significant expansion, of products, services and profits. It has led in many cases to a major increase in vertical integration, with farming cooperatives setting up food production and even retailing outfits and with factories establishing their own supply lines and marketing outlets.

There can be little doubt of the success of these approaches. By the end of 1984 industrial and agricultural output was up 10.2% on the previous year; a year later up 16.4%. National income at the end of 1985 was 12.3% higher than the year before. This has been, as we shall see, directly related to individual pay. It is very apparent to the visitor to China that this is a booming economy where people have money to spend and are increasingly buying watches, television sets and household appliances.

How these policies operate within the enterprises is less clear. So far there has been little grounded study of their impact within employing organisations, especially by Westerners. We were therefore keen to take the opportunities provided by the Commercial Cadre Institute to examine businesses where these changes are supposed to be operating.

The study visit

The changes are built upon a number of key concepts, of which increasing local independence and vertical economic integration have been embraced most enthusiastically. It was, therefore, decided to examine a vertically integrated group of businesses, from farming cooperatives through grain mills, an abattoir and a shoe factory, food processing and manufacturing to retailing. Interviews were conducted with senior and middle managers often, but by no means always, CPC members and, where appropriate, trade union representatives. The concentration was on the smaller scale

business - one retail outlet employed only six people, the largest 3,600; the smallest food processing plant employed 50, the largest 850; the grain mills employed 335 and 118 respectively and the farming cooperative covered 45,000 farmers. Interviews were conducted on site, through an interpreter. Our team consisted of specialists with backgrounds in accounting, marketing and human resources. Tours of the premises or locality took place in each organisation. At the end of our visit we met with the Vice Minister of Commerce to discuss our findings and Government policy in these areas.

Most of the organisations visited were located in and around Beijing or Xian and the larger organisations at least were clearly used to regular visits from Westerners. The same was not true of the smaller locations and was far from the case at the farming cooperative we visited in Hebe Province, some five hours (often somewhat rough) driving from Beijing and where the locals (and in particular the children) found us to be of at least as much research interest as we found them.

Clearly given the nature of the investigations it is not possible to reach any definite conclusions on the role of management and unions in the new economic and social situation of the late 1980's. Any conclusions drawn about this vast and complex country by visitors from the West should be tempered with a due amount of caution and modesty. Our limited research is of value because of the paucity of empirically grounded analysis of developments in the Peoples Republic of China and because the multi-disciplinary team and the following through of the vertical integration within one sector gave us a rare opportunity for a more detailed examination of changes at the local level.

Our findings are presented in the following way. First we examine the development and use of local managerial autonomy, in particular in financial accountability and the use of retained profits. Then we comment on the development of employee incentives and the role of the trade union in the new, and perhaps to western eyes more familiar, profit-oriented work organisation. Finally we attempt to draw some conclusions about management in China.

local managerial autonomy

In the enterprises that we visited six major areas of increased autonomy were apparent. These were in supplies, in pricing, in advertising, in services, and in the accumulation and use of profits.

Before 1984 *supplies* had in most cases been allocated directly by Provincial or local authorities. Since then the enterprises had been able to go out and negotiate with suppliers. Examples can be taken from the range of organisations. The 'Civilisation Market' in Beijing now not only obtains 20% of its produce from private traders but is free to buy at least some of its supplies from companies outside the Province. No 5 flour Mill in Western Beijing is also free now to go outside the Province to buy its wheat.

The Xian Department Store has since 1979 found itself faced by competition from small local shops, often privately-owned, and has responded in a way that many Western stores would recognise by developing exclusive marketing arrangements with particular factories and suppliers.

The managers in these enterprises are very conscious of the extension of their autonomy. It has to be set in context however. The introduction of major plant is still decided centrally: of the 10 flour mills in Beijing whilst No 5 has equipment made and installed by the British company Henry Simon Engineering Ltd, No 6 has Italian equipment and No 10 has Swiss machinery. These decisions were taken in the Grain Bureau at a level well above the individual mill. Similarly, supplies to retail stores are carefully monitored and limits to autonomy are set by central allocation and pricing mechanisms. All imported goods come through State channels: the individual enterprises have no capability or authority to buy direct.

Most of the products themselves are far from differentiated. The ubiquitous bicycles, for example, are sturdy, long-lasting Raleigh look-alike, almost identical in every shop or store. So far, at least, the Chinese have avoided the development of built-in obselescence.

The second area of increased autonomy is in *pricing*. Not all the enterprises have this autonomy. Certain foodstuffs, for example, are price-fixed by the State. Other

items however have been freed from price controls and the enterprises have been given some limited scope to set their own prices. We could discover no very sophisticated methods for establishing prices. With a strictly limited competitive situation, and little systematic knowledge of their markets, this seems to be an area where the enterprises have much to learn.

We must be wary of applying Western criteria to the Chinese businesses. Companies in the West apply pricing to increase profits. Whilst the profit motive is now well established in China it is not a simple criterion nor is it the only one. Thus retail stores are prepared to keep prices for certain items low so that they were within the reach of all customers. Equally, the stores were prepared to sell price-fixed items on which they made little or no profit simply as a service to the public.

A new approach to *advertising* is also developing. Promotions in general remain relatively simple: street advertising in Beijing is straightforward and tends towards the "heroic" Soviet style. Inside individual stores, however, where the enterprise managers have more scope, the advertisements are more "Western" with realistic and attractive models and, in some cases, moving electronic displays.

Overall, though, China is still very much a seller's market: the demand for consumer goods is still well ahead of supply, especially in electronic equipment. The requirement for persuasive advertising, like the demand for competitive pricing, or easy finance, is therefore still some way away and it is only the more forward-looking businesses that are investing in the kinds of promotion that are more familiar to us.

In the new environment the enterprises are developing *new services* for their customers. Thus flour mills are producing new grades and blends, cake factories are producing different biscuits and cakes (many of them in the now popular 'Western' style) and stores and shops are adding new lines, sometimes doubling or trebling the number available four years ago.

Other services are also being introduced. The market we visited now has a cookery expert in residence able, over a cup of tea, to explain how to cook more recently introduced items or to suggest new recipes. The cake factories have expanded their operation into a cafeteria restaurant. This enables them to clear unsold stock, to

test out new products, to increase profits and to provide another service for the people of Beijing.

These services are not being produced Western style. Either because the Chinese are as yet unable to price and market them effectively, or because they have a more "social" and less "market" oriented view of service. However, the overall effect, again, is to develop an enterprise system and approach which is much closer to the customer focussed approach of Western businesses.

The fifth of these six areas of increased local autonomy lies in the ability of the enterprises to *accumulate profits*. Until 1984 most of the businesses we visited had remitted surpluses of income over expenditure (had there been any) back to the Ministry of Commerce. From 1984 onwards the businesses were taxed, the restricted autonomy on supplies, pricing and services that we noted above was introduced - and the enterprises were free to accumulate any resulting surpluses of income over investment as profit.

The effects were significant at all levels. The small shop that we visited had six employees. Until 1984 it had been run by the State: in the last year of direct State control it had made a surplus of 10 yuan. The creation of profit had not then, of course, been an objective. By matching income to costs the shop was operating efficiently. In 1984 control of the shop had been handed over to the employees. The, relatively young, manager and her five staff now had to pay a rent, interest on loans (at 7%) and their own salaries. They paid no tax. By 1987 the shop was making a profit of 20,000 yuan per annum. This has been achieved by a process of monthly meetings between staff and customers in the locality which enabled the shop to tailor its stock much more closely to local needs. It now, for example, sells meat and many small items, like batteries and needles, which it had not offered before. Some items, including alcohol, on which there was a more substantial profit, have been increased and displayed more prominently. The layout of the shop in fact had been improved and brightened.

The sixth major area of increased autonomy concerns the *distribution of profits*. This varied with organisations. In China the smaller organisations pay little or no tax on profits, whereas the larger ones pay a substantial proportion of their profits in tax. In broad terms there are three potential destinations for profit: taxes, reinvestment in the

enterprise and distribution to employees. This last element is the subject of the next section but the first two need further comment here.

For the larger organisations we visited tax was typically 55% of profits. However, a secondary tax operates as an equalisation method, so that organisations which are in some way fortunate do not make excessive profits over those less well favoured. Thus a retail organisation in a particularly well-developed city centre site will pay up to 35% additional tax over one located in a small rural town; a well equipped and well-sited factory will pay more tax than one with long supply lines or one distant from its market.

Sums remaining after tax are split between reinvestment and employee bonuses. The allocation of the money between these two is a matter for management decision. But it is a decision in which two groups, unusually to Western eyes, the Communist Party and the trade unions, are involved. The role of the Communist party officials did not appear to be very significant. It is difficult to know, without comparative evidence, how much of a change this is. Clearly some senior managers were party officials, but many were not even party members. The previously powerful party secretary was only in evidence in a few of the organisations we visited. Our impressionistic view is that their power has declined (4), but that within the smaller enterprises it was never perhaps as central as it used to be in the larger organisation.

The second group, the trade union officials, are frequently consulted and manifestly work closely with the enterprise managers. They are involved in decisions on the allocation of profits. Concepts of "negotiation" are inappropriate in the Chinese context. The interests of management and union are seen as identical. There are no external shareholders so the only question is one of immediate distribution to employees or reinvestment for the future benefit of customers and employees alike.

Employee incentives and the role of the union

Much of our analysis has focussed on the increased autonomy of local level management, in particular in the creation and distribution of surplus cash. Some of this cash goes to the employees. Before we detail the way in which this system operates in practice it is worth setting in context. Before we discuss the non-farming sector it is worth repeating the fact that most people in China are at work in agriculture. By far the most typical organisation we visited was the farming cooperative. Other sectors of

the PRC economy are still very small in comparison with farming. The farming community shares many of the developments in other sectors that we have indicated. However, apart from a small administrative cadre, and increasingly some of the workers in the mills and shops, the cooperatives do not employ people in the sense that other organisations do; in the cooperative we visited only 234 of the 45,000 involved were employees. Investigations of the organisation and reward of farmers are worth a separate study. This section concentrates on the way the new policies have had an impact on employees and unions in the processing, manufacturing and retail sectors.

Some elements at least of the new policies in these areas have a clear and direct effect on employees and may be creating a new and unfamiliar role for the trade unions at the local level. Within limits, retained profits can be used by the local management as they deem fit. Invariably a substantial proportion of this money is distributed to employees in the form of a supplementary bonus in each wage packet. Amongst the organisations we visited this bonus ranged from almost 100% of the total (in the case of the small shop) to around 25%. In wage terms the bonus was typically some 40% of an individual's pay. There is considerable variety; some organisations fixed the bonus at a percentage of each worker's pay, although most paid a flat sum so that, in contrast to some notable recent examples in the UK, performance bonuses were of much greater value at the lower level. In a typical example basic grade shopfloor workers in one department store received on average 70 yuan per month, of which 20 yuan would be the bonus payment. Senior management received on average yuan, of which again 20 yuan was bonus.

The bonus is theoretically performance-linked in two ways. Practically, it was our impression that this performance linking is modified in both cases. First, it reflects the retained profit of the organisation: hence the more profitable the organisation the more bonus there will be to share. In practice, the proportion of the retained profit that goes to bonus varies with the managerial objectives in developing the business. The small shop had few pretensions to expand and was able to share out most of the retained profits to the workers. The bigger department stores we visited all had substantial expansion plans, as we have reported above, and therefore diverted a high proportion of retained profit for that purpose.

Second, the bonus is performance linked on an individual basis. It reflects individual performance; bonus is distributed amongst employees on grounds familiar to

any performance appraiser in the West - effort, commitment, particularly effective work, beating of targets and so on. Again we received a clear impression that the reality of these bonuses is not as disparate as the theory might suggest. Clearly most people received the laid down maximum bonus and it was only in a few cases that the bonus was reduced or withheld as a "fine" for poor performance.

The role of the trade union in this process is akin to that of the old-style Personnel department in Britain. They are closely involved with all aspects of the allocation of profit and bonus. They try to ensure that each individual is treated considerately and fairly and, indeed, carry out a familiar seeming welfare role (including sorting out personal problems like housing and taking flowers to sick colleagues). However, in a manner that must ring bells with at least older personnel specialists in the UK, they are also involved in setting production targets, in mediating between individuals and between individuals and management, and in the carrying out of disciplinary action.

There is little evidence of conflict in this dual role. This is not surprising. The effect of the new autonomy and bonus system has been manifest. After years of only gradual improvement there has been a very real and substantial increase. Basic salaries in most of the organisations we visited are set by the State and increased in line with the controlled increases in the prices of foodstuffs, clothing and other basic necessities. The effect of the new bonus schemes has meant a dramatic increase in spending power. This increase in disposable income far outstrips the increase in inflation (6% in 1986; 10% in 1987). It is seen by managements, unions and workers as directly linked to the efficiency and profitability of the enterprise. In the event the union role, of helping to ensure fairness in the distribution of abundance, is uncontroversial.

The Pace of Change

As we have already indicated the Chinese are used to change. There have been substantial and traumatic shifts of policy and practice which have affected the whole population. Managerial cadres within the businesses have experienced as much change as anyone. There was a general consensus by everyone we saw on two aspects of the last few years. First, the autonomy given to each enterprise is now far greater than at any previous point in Chinese history since 1949. These organisations are working very hard

to come to terms with their new responsibilties and accountabilities and are, to a team of British management educators, refreshingly open about their need to learn quickly.

The second aspect on which all those we spoke with were agreed is that the changes are probably irreversible. Despite the attention paid in this article and elsewhere to the introduction of these changes, China is still a centralised, Communist society, and all but the very smallest businesses are publicly owned. Within this context, however, individuals are finding themselves increasingly independent at work, increasingly well-paid and increasingly well-off. In the circumstances they are unlikely to respond positively to those in the Party who are warning that there may be a need to take a few steps backward. The fact that similar policies and similar success are being experienced in the dominant agricultural sector reinforces this view.

Our impressionistic view is that, within the Chinese system, the spirit of enterprise is increasingly alive and well. As in the West, this may not always be of the best taste - the garish "Great Wall Antique Store" prepared for foreign visitors to the Great Wall* is hardly elegant. But it does indicate the extent of the change in China in the last few years.

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2. Henley J S and Mee Kan Nyaw "Introducing Market Forces into Managerial Decision-Making in Chinese Industrial Enterprises" Journal of Management Studies Vol 23, 6 1986 pp 635-654

3. reported in the Independent 27 October 1987 p 12.

4. Henley and Mee, op cit p 645

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He has worked for a major trade union; for the Commission on Industrial Relations; a specialist Industrial Relations magazine and for Industrial Relations Law Reports. He has held management and training positions in the construction and air transport industries. He has acted as a consultant to UK and international organisations mainly in the areas of personnel policies and management training. He is the author of several books, including "Cost Effective Strategies in Industrial Relations" (1985), and "A Management Guide to Industrial Relations" (1986). He is also author of numerous articles and most recently of a monograph on "The Management of Expatriates" (1988).

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