FACTORS ASSOCIATED WITH THE COMPENSATION DECISION IN FOREIGN INVESTED ENTERPRISES (FINs) IN CHINA

GENG NA

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Employee compensation is very important for an organization’s development. The objective of this research is to find out which factors will influence employee compensation, and examine the main compensation components and compensation system in foreign invested enterprises in China. The literature review provides plenty of studies about this area which have done by some researchers. The respondents were based on a sample population. The questionnaires were constructed out of extensive literature review. And the hypotheses were tested by using SPSS program of reliability analysis, descriptive analysis and multiple regression. This research discovered that employee performance, job position, education and working experience have a positive significant impact on employee compensation, gender has a significant impact, and employee loyalty still have an impact on employee compensation but not significant.
ABSTRAK

Faktor—Faktor Berkaitan Dengan Keputusan Compensasi Di Sektor Perniagaan Pelaburan Asing Di Negeri Cina

Tekanan pekerjaan merupakan isu yang sangat penting dalam mana-mana organisasi. Kajian ini ialah mengkaji sama ada tempat pekerjaan hubungan antara pekerja, hubungan di tempat keja, struktur kerja, suasana member impak positif dan signifikan terhadap tekanan dalam pekerjaan.

Faktor demografi iaitu umur dan jantina juga dikenali hubungan antara tempat pekerjaan dan tekanan. Soratan literatur yang mendalam telah dibincang untuk variabel-variabel yang mempengaruhi tekanan kerja. Responden kajian dipilih secara random dari populasi kajian dan satu soal selidik yang extesif telah disediakan berdasarkan sorotan literatur. Oleh itu, kajian kali ini telah menggunakan SPSS program telah membuktikan tekanan mempunyai positif imek dan mempengaruhi dalam tempat pekerjaan tetapi misi dalam perkerjaan pula mempunyai negative imek dan tidak menunjukkan bahawa boleh mendapat tekanan perkerjaan. Umur dan jantina tidak mempengaruhi hubungan antara factor tempat kerja dan tekanan kerja.
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CHAPTER 1

INTRODUCTION

1.1 Research Background

Compensation is a tool used by management for a variety of purposes to further the existence of the company. Compensation may be adjusted according the business needs, goals, and available resources (Bergmann & Scarpello, 2002). However, how to build an effective compensation system? This may be the most difficult task for HR departments in almost all the companies. And this problem also attracts the attention of foreign invested enterprises in China. Nowadays, foreign invested enterprises have shared one fifth of China's market (Reuvid & Li, 2005). Since the 1980s, China has devoted great human, material and financial resources to construct infrastructure facilities to help create a favorable environment for foreign investors to invest. The Central Government has promulgated more than 500 foreign-related economic laws and regulations to provide legal and other guarantees for foreign investors in China. At the end of 1997, China revised and promulgated the Foreign Investment Industrial Guidance Catalogue to encourage and support foreign businesspeople to invest in the comprehensive development of agriculture, energy, communications, important raw and processed materials, new and high technology, the comprehensive utilization of resources, and environmental protection. In accordance with the rules of the WTO and China's undertakings, China has basically completed the rationalization and revision of foreign-related economic laws and regulations. By the end of 2004, foreign businesspeople from more than 170 countries and regions had invested in China. Of the world's top 500 transnational companies, over 400 have invested here. China has been hailed by investors and the financial world as among the countries with the best investment environment (Reuvid & Li, 2005).

According to the Ministry of Commerce report, from 1979 to 2006, foreign capital utilized by China in real terms totaled US$743.6 billion, including US$560.4 billion of direct investments by foreign businesspeople. In 2006, foreign investment maintained
its momentum of rapid increase, and foreign capital utilized in real terms for the year totaled US$64.1 billion, of which direct foreign investment amounted to US$60.6 billion. And the newest report presented that the amount of foreign capital actually used in China in January, 2008 was 11.2 billion US dollars, an increase of 109.78% over the same period last year. And the following Figure 1.1 demonstrates the growth of utilized foreign capital in real terms from 1990 to 2006.

![Figure 1.1 Growth of Utilized Foreign Capital in Real Terms](image)


The high investment in China is linked tightly with the high profit. And international investors are rapidly changing the landscape of market share to make sure they will get a high profit. Ma Qing, an economist with the Monitor Group (2008) reported that "China's economy is going better. Foreign companies can get a higher payback from investing in China than in other countries. China remains one of the most attractive FDI (Foreign Direct Invested) recipients in the world." And "The Chinese leadership assured foreign investors at the 17th Party congress in the year 2007 that China will stick to its reform and opening-up policies," Wang Zhile director of the Multinational Enterprise Research Center affiliated to the Ministry of Commerce, said. "It is taken as a good opportunity by many foreign investors."

In addition, compensation in foreign invested enterprises attracts more and more research. There is no single "model" for wage payments to staff and workers of foreign invested enterprises in China. In general, the wage level can be broken down into the
following five components: basic wage, floating wage, position wage, piece-rate wage, and bonus (Strange, 1997). Each FIE enjoys autonomy in deciding a wage pattern which suits them best. A survey conducted in Shenzhen reveals that employees of foreign invested enterprises were generally satisfied with the level of wages they received. This can be explained by the fact that employees received higher wages that their counterparts in SOEs (State-Owned Enterprises). According to CFO’s report (http://cfo.icxo.com/), “Financial Controller Compensation Research 2005”, the compensation of financial controllers, financial vice-president and general accountant in Chinese companies, foreign invested enterprise is highest, annual average reaches 50.5 RMB, then the following one is private enterprise, the average is about 25.4 RMB, the lowest compensation exits in state-owned enterprise, only 23.7 RMB. Not only the top positions’ compensation is higher in foreign invested enterprises, based on the research by Zhongzhi Human Resource Management Limited Company, the average compensation in foreign invested enterprises is also 13.5% higher than other similar enterprises. And now the compensation is in a growth trend. In 2007, the average rate of compensation increase is about 8.5%. And the research predicts in the following two years, the growth will be still in an upward trend.

Thus, it is important to understand the factors that influence on compensation in foreign invested enterprises. In today’s China, compensation takes on a new word, dai yu. It’s not just a symbol for logs and water, or providing the necessities in life. It refers to how you are being treated-your wages, benefits, trainings, opportunities, and so on. The compensation now includes a broader sense of returns, and rewards, as well as entitlement (Milkovich & Newman, 2005).

1.2 Problem Statement

Most of today’s employee compensation systems were originally developed in the old, factory environment stemming from how hourly workers were paid, and graduating upwards in the hierarchy (Caruth & Handlogten, 2001). A job received fixed pay, with annual pay increases based on performance and the expectation of lifetime employment (Hwang & Kleiner, 2002). However, the old system exits some problems, and so nowadays most of the companies choose performance-base system to determine the compensation. The new system gives people immediate and meaningful
feedback, with measurable objectives. The easiest targets to quantify are those based on bookings, shipments and profit (Caruth & Handlogten, 2001). Pay is based on whether or not plans or budgets are met – usually monthly, but quarterly and even annually for top managers (Irlenbusch & Ruchala, 2005).

Moreover, researchers also specified and estimated two related models of the compensation between increased performance-sensitivity in compensation and increased subsequent corporate performance (Gerhart & Milkovich 1990). The first model, a discrete formulation, focuses on the conditional probability of good future corporate performance given current corporate performance and the current association between pay and performance. In this model increased performance-sensitivity is accomplished by increasing the probability of high pay when there is high performance and low when there is low performance. The second model, a continuous formulation, focuses on the conditional expectation of future corporate performance given an elaborate, nonlinear function of current performance and compensation (Abowd, 2000). In recent years, agency theory has also emerged as the principal theory guiding organizational research on the pay-performance relationship (Gerhart & Milkovich, 1990).

However, Goh Hern Yin, China’s district manager of Human Resource Company pointed out that many foreign invested enterprises have difficult to establish effective performance reward system (www. expo-China.com, 2007). And in some enterprises the employees’ performance are gradually ignored when determining compensation, even though the employees’ performance are not good, they also can get a high compensation. Nay based on the statistics listed by CHO.ICXO.COM (2007), there exist many empty positions. According to the survey with 500 foreign invested enterprises, the result shows that 77% enterprises express they have a “certain lack”, or “high lack”, or “extremely high lack” of research development positions, 63% enterprises indicate they have a “certain lack”, or “high lack”, or “extremely high lack” of sale positions, and 55% enterprises demonstrate they have a “certain lack”, or “high lack”, or “extremely high lack” of program development positions. Among the three category positions, the urgent need is stager, then it is the junior position, and the last one is sale and management position. As a consequence, foreign invested enterprises have to increase compensation to attract employees and remain exist employees. The following Figure1.2 presents demand of the hot positions in 2007 in research development, sale and program development.
Figure 1.2 Hot Positions in 2007

Source from: CHO.ICXO.COM (2007)

So in foreign invested enterprises, compensation does not just related to performance. Performance is only one of all the factors.

1.3 Research Objectives

This paper aims to report a study to analyze the factors which affect compensation decision in foreign invested enterprises in China.

The objectives of this study are:
1. to identify the main factors that influence on the compensation decision in foreign invested enterprises.
2. to examine the most popular compensation system used in foreign invested enterprises.
3. to analyze the compensation components in foreign invested enterprises.
4. to explore the challenge of establishing effective compensation systems faced by foreign invested enterprise.
1.4 Research Questions

The main research questions concerning this study are:

1. What are the main factors that influence on the compensation decision in foreign invested enterprises?
2. What is the most popular compensation system used in foreign invested enterprises?
3. What are the main compensation components in foreign invested enterprises?

1.5 Scope of Study

This study focuses on the analysis of factors influence on compensation and look into the problems of compensation system faced by foreign invested enterprises. In China there are four types of foreign invested enterprises, Wholly Foreign Owned Enterprises, Equity Joint Ventures, Cooperative Joint Ventures and Resident Representative Office. The subject identified for this study focuses on Equity Joint Ventures in electronic industry in Shandong Province.

1.6 Significant of the Study

With vast amounts of foreign invested enterprises entering China’s market, establishing a perfect compensation system is quite important. And now there is a strong need to build a good compensation system among foreign investors. So it is hoped that the result of this study will provide some useful information of managing compensation for the human resource managers in foreign invested enterprises. And this study also attempts through quantitative analysis to identify the key elements in determining compensation. What’s more, the finding will benefit foreign investors by presenting the improvement and development of existing compensation system.

However, this study still has some limitation. The first limitation is that the sample doesn’t cover all the industry, only focus on electronic. Another limitation is that the study only concentrates at the area of Shandong Province, in China.
1.7 Definition of Terms

1.7.1 Foreign Invested Enterprises
Anyone of a number of legal structures under which a company can participate in the foreign economy. FIEs tend to have tight government regulation at nearly every important business juncture, which limits the efficiency at which any foreign company can profit from foreign ventures as well as the amount of control that a foreign parent has over the FIE (Zimmerman, 1999).

1.7.2 Equity Joint Ventures
Parties may operate as separate legal entities and bear liabilities independently or may be registered as a limited liability company. There is no minimum foreign contribution required. Contributions can be labor, resources, and services. Profits are divided according to the terms of the cooperative venture contract rather than investment share. Parties can decide the term of operation subject to the approval from government. Foreign investor is permitted to withdraw capital during the duration of the CJV operation. And free to hire Chinese nationals (Zimmerman, 1999).

1.7.3 Compensation System
The workers compensation system is a form of social insurance that provides injured workers with medical care, income (or a percentage of income), and survivor benefits in cases of fatalities. The worker, in turn, waives the right to sue his or her employer under common law (Cho, 2003).
1.8 Summary

This chapter has given a whole introduction of the situation of foreign invested enterprises in China and pointed out the problems of their compensation system. Furthermore, it also indicated the main objective of this study and presented the research question in order to demonstrate the direction of this study.
CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

In chapter one, the problem that employees' compensation are affected by many factors has been put award and the problem that what compensation components and compensation system most of foreign invested enterprises adopt also has been presented.

In this section, the research will give an overview of the subject, issue or theory under consideration, along with the objectives and explain how this study varies from previous research. And also determine which literature makes a significant contribution to the understanding this topic.

2.2 Compensation

Compensation refers to all forms of financial returns and tangible services and benefits employees receive as a part of an employment relationship (Milkovich & Newman, 2005).

Compensation includes topics in regard to wage and/or salary programs and structures. It is payment to an employee in return for their contribution to the organization, that is, for doing their job. The most common forms of compensation are wages, salaries and tips (McNamara, 2004).

Compensation is usually provided as base pay and/or variable pay. Base pay is based on the role in the organization and the market for the expertise required conducting that role. Variable pay is based on the performance of the person in that role, for example, for how well that person achieved his or her goals for the year.
Incentive plans, for example, bonus plans, are a form of variable pay. (Some people might consider bonuses as a benefit, rather than a form of compensation.) Some programs include a base pay and a variable pay.

### 2.2.1 Compensation Component

Total compensation can be categorized into cash compensation and benefits. Cash compensation includes base, merit/cost of living, short-term incentives and long term incentives. Benefits include income protection, work/life focus, allowances. Figure 2.1 exhibits the structure of compensation.

![Figure 2.1 Compensation Component](image)

**Source from:** Milkovich & Newman (2005)

**Cash Compensation: Base**

Base wage is the cash compensation that an employer pays for the work performed. Base wage tends to reflect the value of the work or skills and generally ignores differences attributable to individual employees. Base salary is one of the main determinants that employees use when they make an employment decision (Gerhart and Milkovich, 1992).
Cash Compensation: Merit Pay/Cost-of-Living Adjustments

Merit pay are given as increments to the base pay in recognition of the past work behavior. It is widely used to reward good work performance (Lawler, Ledford & Mohrman 1989, O’Dell, 1987). Some assessment of past performance is made, with or without a formal performance evaluation program, and the size of the increase is varied with performance. In contrast to merit pay, cost-of-living adjustments give the same percent increase across the board to everyone, regardless of performance (Milkovich & Newman, 2005).

Cash Compensation: Incentives

Incentives tie pay increases directly to performance. However, incentives differ from merit adjustments (Milkovich & Newman, 2005). First, incentives do not increase the base wage, and so must be re-earned each pay period. Second, the potential size of the incentive payment will generally be known beforehand. Whereas merit pay programs evaluate past performance of individual and then decide on the size of the increase, the performance objective for incentive payments is called out very specifically ahead of time.

Incentives can be tied to the performance of an individual employee, a team of employees, a total business unit, or some combination of individual, team, and unit. The performance objective may be expense reduction, volume, increases, customer satisfaction, revenue growth, return on investments, or increases in total shareholder value—the possibilities are endless (Kerr, 2003).

Because incentives are one-time payments, they do not have a permanent effect on labor cost. When performance declines, incentive pay automatically declines, too (Milkovich & Newman, 2005).

Long-Term Incentives (Profit Sharing)

Long-term incentives (profit sharing) are intended to focus employee efforts on multiyear result. Typically they are in the form of stock ownership or options to buy stock at specified, advantageous prices (Rodrick, 1998). Long-term incentive ranked quite high in the "motivation" dimension and not in the retention dimension. Long-term reward is important to motivate employee. Profit sharing motivates employees to become better performers and links with organizational performance (Weitzman and Kruse, 1990). It educates employees about the financial performance of the business,
increase their interest in learning about profits and organizational effectiveness (Foulkes, 1991), motivates employees to act in the best interest of the organization, helps employees identify with the organization, encourages employees to think like owners, and taps on organizational performance, and adjusts them based on the organization’s ability to pay (Weitzman, 1984).

Benefits: Protection
Different counties have different lists of mandatory benefits. Medical insurance, retirement programs, life insurance, and savings plans are common benefits. They help protect employees from financial risk inherent in daily life. Often companies can provide these protections to employees cheaper than employees can obtain them for themselves (Williams, Malos & Palmer 2002).

Benefits: Work/Life Focus
Programs that help employees better integrate their work and life responsibilities include time away from work (vacations, jury duty), access to services to meet specific needs (drug counseling, financial planning, referrals for child and elder care), and flexible work arrangements (telecommuting, nontraditional schedules, nonpaid time off) (Milkovich & Newman, 2005).

Medtronic believes that this program permits employees to be “fully present” at work and less distracted by conflicts between their work and nonwork responsibility.

Benefits: Allowances
Allowances often grow out of whatever is in short supply. And companies that resist allowances must come up with other ways to attract and retain talented employees. Housing and transportation are frequently part of the pay package in China (Tuis & Lau, 2002).

2.2.2 Compensation System

The workers compensation system is a form of social insurance that provides injured workers with medical care, income (or a percentage of income), and survivor benefits in cases of fatalities. The worker, in turn, waives the right to sue his or her employer under common law (Cho, 2003). In an ever more competitive business environment,
both locally and globally, many companies today are attempting to identify innovative compensation system that are directly linked to improving organizational performance (Appelbaum & Batt, 1994.). And nowadays, most of companies pay their attention on the design of compensation system which is suitable for their real situation. The most popular compensation systems include: pay of performance, incentive pay, gain sharing/team-based pay and contribution and Hybrid pay system (Chow, 2004).

Pay for Performance
In pay for performance systems, a percentage increase in pay depends on the employee’s achievement of predetermined measurable production, operations, or other goals. Pay for performance systems can measure individual, group or organizational performance, and different types of systems are often used together (Cornetta, Marcus, & Tehranian, 2007).

Incentive pay
Incentive pay is given to employees in addition to their base wage, and is intended to induce action or provide motivation. Rather than rewarding employees for their performance, incentive pay can be provided to encourage behaviors and outcomes. Incentive pay can be used as a management tool as well as compensation scheme (Fan & Grossman, 2000).

Gain sharing/Team-based Pay
Gain sharing or team-base pay is a method of linking the pay of employees to level of performance that they have achieved in a team, and rewarding the group for improving productivity and meeting organizational goals. By rewarding the group performance through the recognition of successful teamwork, an organization can harness the collective potential of employees. Team-based pay can be applied on the basis of how well employees have performance across the whole organization or it can be based on departmental activity or project (Chow, 2004).

Contribution and Hybrid Pay System
Contribution pay combines elements of performance and competency-based pay scheme by recognizing the employee’s performance and results, as well as the competencies that they have used to achieve those (Dulebohn & Werling, 2007). Unlike strict pay for performance schemes, contribution or hybrid pay does not solely provide a direct incentive for achieving a defined set of targets. In conjunction with a
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