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Adaptation of compensation practice in China: A qualitative configurational analysis

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Adaptation of Compensation Practice in China: The Role of Sub-national Institutions

Abstract

Unlike previous research that has largely focused on the influence of national institutions on human resource management practices in China, our study taps into the role of sub-national institutions. We demonstrate, via a qualitative configurational analysis, that foreign subsidiaries of multinational corporations still adapt HQ compensation practice to the local context despite low regulatory pressure and low mobility of skills at sub-national level. This adaptation is facilitated by a decentralized structure in the multinational corporation. Our study also shows that high regulatory pressure and high portability of skills at the sub-national level alone are sufficient to induce local adaptation of compensation practice. Our explanation points to the significant role played by sub-national institutions in large and rapidly changing emerging economies and contributes to research on local adaptation of HRM practice in China. It offers an insight into forms of institutional agency by political and economic actors at local levels of governance as they attempt to influence the skills and human resources available for MNCs through regulatory means.

Key words: sub-national institutions, China, adaptation of compensation practice, Qualitative Comparative Analysis (QCA), MNC decentralization

INTRODUCTION

Shanghai has its own labor regulations that are detailed rules about how to implement the national labor law in terms of e.g., work attendance, workplace accident, minimum wage, salary calculation and overtime pay. These regulations are different in different regions and cities.

- China HR Director, Finnish multinational corporation

As the above quotation suggests, local regulations can have major effects on how labor is managed across regions in China. However, research on human resource management (HRM) practices in China has predominantly focused on the influence of national institutions. This stream of research has largely drawn on the global integration-local responsiveness debate (e.g. Almond, Muller-Camen, Collings & Quintanilla, 2006; Festing, Eidems, & Royer, 2007; Edwards, Edwards, Ferner, Marginson, & Tregask, 2010; Festing & Sahakiants, 2013). Although the role of local or sub-national institutions in emerging economies is recognized for investment decisions and firm performance (e.g. Kwon, 2012; Nguyen, Le & Bryant, 2013), the relative impact of these institutions on HRM practices and, in particular, on compensation practice has remained unclear. Sub-national institutions are within-country variations of institutions, or local institutions residing within a country (Nguyen et al, 2013; Ma, Ding & Lin, 2016). They constitute the infrastructure of the multinational corporation (MNC) that shapes how relations between firms, government, research organizations and training systems are coordinated. They provide foreign investors with economic incentives to access scarce resources and business ecosystems that foster a sense of identity and innovation (Meyer & Nguyen, 2005; Estrin; Chan, Makino & Isobe, 2010), as well as regulatory, normative and cognitive structures for attaining legitimacy (Sanders & Tuschke, 2007).

Despite calls for studies of the impact of sub-national institutions on HRM practices by comparative institutionalists (e.g., Ferner & Tempel, 2006; Almond, 2011), empirical research remains scant. Although the examination of host country effects has been central to HRM research, the changing nature of these effects has not received due attention. Sub-national institutions are particularly relevant in emerging economies in general, and in China specifically, given their economic and political liberalization. The transformation in China from a centrally planned economy toward a market economy over the past four decades has led to conspicuous regional differences in, for instance, policies and regulations, education and labor market conditions as well as economic development (Chan et al., 2010).

We, therefore, seek to address this significant gap by taking a qualitative configurational approach (see Fiss, 2009) to understanding how firm-level conditions interact with sub-national institutional conditions in China. We examine the adaptation of compensation practice as a configuration (see Grandori & Furnari, 2013). In other words, we consider compensation practice as a bundle of constituent aspects which are aligned with one another rather than in isolation. We ask under what conditions subsidiaries of Finnish MNCs adapt compensation practices in China. Our interest lies in explaining how labor regulations and portability of skills at the level of municipalities, when combined with MNC decentralization, influence the adaptation of compensation in China. We focus on compensation practice as it is typically susceptible to pressures from both the MNC parent and local Chinese host context (Lu, 2014). Subsidiaries of foreign MNCs seek to adapt their compensation practice in an effort to recruit the best managerial and professional talent in an environment where such talent is limited (IMD World Talent Report, 2016). MNC decentralization may facilitate such adaptation. We understand compensation practice as the sum of elements concerning pay mix and pay level. The focus of our study is on key managerial and professional employees at foreign subsidiaries of MNCs in China.

Our contributions are twofold. First, we advance the understanding of the significant impact of sub-national institutions on adaptation of compensation practice in China. Our study demonstrates that municipal labor regulations play an important role in explaining the adaptation of MNC HQs' compensation practice to the Chinese environment. Comparative Institutional Analysis of compensation practice has widely examined the impact of national regulations and trade unions (see Marín, 2008). This national approach is based on the premise that most important institutional structures, namely labor market regulations, education and training, and corporate governance, depend on the regulatory regimes of nation states. We align our investigation with the more recent inquiry into international HRM by comparative institutionalists (e.g. Monaghan, Gunningle & Lavelle, 2014; Almond, Ferner, & Tregaskis, 2015) who acknowledge the potential effects of sub-national governance on the adaptation of compensation practice. We advance these debates by highlighting that sub-national actors have the potential to attract and retain MNC activity.

Second, we contribute to international HRM research by undertaking a qualitative configurational analysis of the impact of host institutional and organizational conditions on the adaptation of compensation practice. We show that it is the combinatorial rather than the independent effects of conditions that lead to adaptation. This addresses the inconclusive findings offered by research on HRM practices in China that adopts either a local responsiveness (e.g. Gamble, 2003), or a global integration (e.g. Björkman & Lu, 2001) perspective. Even among the few scholars who acknowledge that various influences can be seen to act together (e.g. Aguzzoli & Geary, 2014), the emphasis is on the independent effects of these influences on compensation practice.

The next section introduces the theoretical background to the institutional and organizational conditions that influence, in combination, the adaptation of compensation practice, and how this configurational thinking extends previous research. This is discussed in the context of China. We then present our methodology, a qualitative comparative analysis (QCA) followed by our findings. Having positioned our findings in the extant literature on HRM practices in China, we draw implications for future research on compensation practice.

THEORETICAL BACKGROUND

Sub-National Institutions in IB Research

The significance of sub-national institutions in firm decisions has been acknowledged in international business research that integrates economic geography (e.g. Meyer & Nguyen, 2005; Chan et al., 2010; Beugelsdijk & Mudambi, 2013; Monaghan, et al., 2014). The role of sub-national or local institutions is especially important when studying firms in emerging economies where institutions are seen as overly complex and rapidly changing (Nguyen et al, 2013), and there are significant differences within these economies, particularly, in China (Chan at al., 2010; Kwon, 2012). Foreign investors are attracted to locations where sub-national institutions facilitate access to scarce resources (Meyer & Nguyen, 2005). For instance, transparent provincial policies in Vietnam are demonstrated to favourably moderate the contribution of an export strategy to firm performance. The transparency of policies and availability of information reduces uncertainty, enabling firms to make informed strategic choices and allocate resources more effectively. They can access more easily different local customers and distribution channels (Estrin et al., 2008).

Firms accommodate sub-national institutions in their investment decisions (Meyer & Nguyen, 2005), because these institutions affect foreign affiliate performance (Chan et al., 2010; Ma, Tong & Fitza, 2013) as well as the economic attractiveness of a region (Shi, Sun & Peng, 2012). Local governments can promote inward investment, trade and new business creation, and preserve the historical and cultural heritage of the state or province, thus fostering networks in which organizations feel a sense of belonging and identity (Chan et al., 2010). Such localized 'ecosystems' can compete on value and innovation, potentially enhancing the embeddedness of MNC units in sub-national geographies (Phelps et al., 2003). Consequently, foreign firms can benefit from linkages with sub-national institutions that allow them to gain access to favorable transactions with potential exchange partners and to reduce the information and search costs associated with finding resources that are critical to a firm's performance (He, 2002).

Limited Attention to the Role of Sub-National Institutions in Adaptation of Compensation Practice

While the significance of sub-national institutions in emerging economies for investment decisions and firm performance is well documented in the IB literature, the relative impact of these institutions on compensation practice has remained unclear. The focus has been on cross-country differences (Meyer, Estrin, Bhaumik, & Peng, 2009). The competing pressures of global integration and local responsiveness (Prahalad & Doz, 1987) have served to explain, to a large extent, why compensation practice may be adapted across national borders. Since compensation practices are exposed to institutional differences between home and host countries, they may be adapted to host context expectations (Almond et al, 2006). Subsidiaries are also inclined to address the regulative structures, and normative and cognitive understandings of the host country in order to gain legitimacy. For instance, in their case study of a European MNC, Festing et al (2007) reveal that while the HQ standardized rules in basic pay, long-term and short-term incentive, some aspects of compensation, such as the range of bonuses, fringe benefits and currency bases were adapted to the local conditions. These adaptations were the result of host institutional and cultural demands, as well as the strategic position of the subsidiaries in question. Similarly, Festing and Sahakiants (2013) highlight that the local adaptation of practices ranging from pay-for-performance and bonuses to social benefits, because MNCs aim to comply with host regulations or cultural norms.

At the same time, several studies have emphasized the need for firms to increase competitive advantage by adopting universal 'best practices'. Subsidiaries benchmark or tap into the MNC's 'learning network' to emulate the compensation practice of HQ (e.g. Pudelko & Harzing, 2007; Edwards et al., 2010). This 'dominance effect' (Pudelko & Harzing, 2007) is noted particularly in China where the weak host institutional pressures and strong MNC influence via expatriates result in the global integration of subsidiaries (e.g. Björkman & Lu, 2001).

To date, none of these contributions to the debate in international HRM research demonstrate the influence of sub-national variation. Empirical research has remained at the national level (see Myloni, Harzing & Mirza, 2004; Almond et al., 2006; Festing et al., 2007, Festing and Sahakiants, 2013). Yet, sub-national factors such as the coordination of relations between firms, research organizations and training systems can have substantial effects on how labor is managed in MNCs. In response to recent calls to incorporate sub-national institutions into the study of adaptation of practices within MNCs (Almond, 2011; Almond et al., 2015), we draw on comparative institutionalism and the global integration-local responsiveness framework (Prahalad & Doz, 1987) to specify the configuration of conditions that can fundamentally influence the adaptation of compensation practice.

Comparative Institutionalism

Comparative institutionalists examine how institutions across several economic domains (e.g., finance, labor, management, inter-firm relations) interact to form distinct national constellations (Jackson and Deeg, 2008). Institutions exhibit strong complementarities among various domains constituting a comparative advantage for a nation (Whitley, 1999; Hall & Soskice, 2001).

Comparative institutionalism has been widely used to study the diffusion of human resource practices across countries. Operating in more than one country, MNCs confront a multitude of different and possibly conflicting institutional pressures (Ferner & Quintanilla, 1998). Since it is vital for MNCs to establish and maintain legitimacy in their host environments, they need to conform to the legal environment, particularly on labor issues. Unsurprisingly, there has been an extensive study of the impact of national labor regulations and trade unions on firm practices (e.g. Marín, 2008). These efforts are based on the premise that most important institutional structures, namely labor market regulations, education and training, and corporate governance, depend on the regulatory regimes of nation states. More recently, however, comparative institutionalists have acknowledged the potential effects of sub-national governance on HRM practices (e.g. Almond, 2011; Monaghan et al., 2014; Almond et al., 2015). They recognize that there is considerable diversity within most national economies in terms of culture and regulations, in particular in large countries. However, they have not embarked on an empirical substantiation of these influences on international HRM (Delbridge, Hauptmeier & Sengupta, 2011). Our aim is to fill this gap by drawing on two core domains of comparative institutionalism— labor market regulation and skills development system— in our specification of the impact of sub-national portability of skills and labor regulations on adaptation of compensation practice. We focus on the municipal level institutions, as the interpretation and implementation of national labor laws and skills development are largely carried out by municipal governments in China.

Sub-national Portability of Skills

Comparative institutionalists see skills regimes and vocational training systems as core concepts affecting the development of different market economies (Thelen, 2004; Culpepper & Thelen, 2008). The notion of 'skill specificity' and vocational training are focal points of discussion in comparative institutionalism, because they connect the production and innovation strategies of firms with the availability of different types of skills. The distinction between coordinated and liberal market economies (Hall & Soskice, 2001) lies in the distinction between general skills and specific skill systems. General skills (e.g., academic and general professional skills) are formed outside the firm and involve a high degree of portability, because they carry value that is independent of the firm or industry. General skills reduce the dependence of the firm on employees who tend to choose exit over voice in their response to grievance (Aguilera & Jackson, 2003). In contrast, specific skills are firm-specific (acquired through on-the-job training) or industry-specific (acquired through apprenticeships and vocational schools), hence are less portable (Estevez-Abe, Iversen & Soskice, 2001). They are valuable to a given employer or an industry but not to other employers or industries.

Although it is acknowledged that the portability of skills lies at the center of the analysis of institutional arrangements with implications for firm behavior, these discussions have remained at the national level (e.g. Christopherson, 2002; Gallie, 2007; Martin, 2012). We purport that the influence of sub-national skills regimes is as equally significant given the variation in the ability of sub-national governments to shape skills development (Almond, 2011). This is most apparent at the level of higher education in terms of the competencies of graduates and in the capacity of sub-national governments to create exploitable knowledge. Hence, we expect sub-national portability of skills to influence the adaptation of compensation practice.

Studies on skills development in China are primarily conducted at the national level. For instance, Asuyama (2009) shows that 42 per cent of students in upper secondary education enter vocational schools in China. Similarly, OECD (2010) reports that about half of the student cohort in upper secondary education, i.e. about 20 million students, enrolled in vocational schools boost the formation of industry-specific skills. Although China provides vocational education and training to 8.6 per cent of the entire workforce, about 65.2 million people (Asuyama, 2009), it lacks cooperation between employers and vocational schools. Furthermore, there are few regional or sectoral bodies to engage employers and link them with the vocational education system (OECD, 2010).

In contrast, the higher education in China, which produces general skills and increases the portability of skills in a region, has experienced a dramatic expansion since 2000. In 2010 the total number of students in higher education institutions amounted to 31 million (People's Daily Online, 2011), and the percentage of higher education attainment accounted for 8.93 per cent of the total population in China (China Population Census, 2010). Although research on skills formation at the sub-national level is rare, there is some evidence to show that there is variation across regions which can influence employment strategies and practices. It is observed that provinces which have larger percentage of higher education attainment tend to have a lower percentage of vocational education attainment. This points to differences across provinces in the local pool of skills, vocational or higher education, available to employers (e.g., China Statistical Yearbook, 2010-2013).

Companies tend to be reluctant to invest in employee training in China, because they run the risk of losing employees after training. This is fuelled by the fundamental changes that China's overall economic system has experienced from a command economy to the direction of a free market economy. This has also changed the form of employment from life-time, known as the "iron bowl" within one organization to fixed-term employment based on labor contracts. The use of short term contracts has prevailed, in particular, in the private sector (among Chinese domestic and foreign firms) where the turnover rate of 20 per cent to 40 per cent has been fairly common (Kilian et al., 2012). The ongoing social reform in relaxing the residence registry system ('Hukou'), especially in recent years, has greatly facilitated labor mobility across regions (the residence registry is the product of the central planning regime that has tied people to their birth place and severely restricted the spatial mobility of labor and divided the population into rural and urban societies with different rights to assess job opportunities and social welfare). In addition, China has been facing serious shortages of managers as a result of continuous high economic growth over the past three decades. The competition for talent has also extended to workers (Das & N'Diaye, 2013). This further encourages employees to move between firms and actualize their market value. At the same time, firms facing scarcity of skills are aware of the need to invest in in-house training to develop their own capabilities. These pressures point to the significance of analyzing the sub-national portability of skills in the adaptation of compensation.

Sub-national Labor Regulation

Sub-national variations in institutional arrangements provide considerable space for firms to choose from among alternative paths or actions. Sub-national regulations can create local forms of comparative (dis)advantage for MNCs (Peck &Theodore, 2007). For instance, resources of different places within a region can be coupled to meet the changing strategic needs of global production networks (Almond et al., 2015). Such sub-national arrangements have implications for our understanding of what happens to MNC compensation practice in China.

National laws and regulations in China are defined broadly to enable flexibility in their implementation by sub-national governments. Since the introduction of the first national labor law—the Labor Law in 1995— there has been a proliferation in the number of labor laws and regulations and a diminishing role of the national state in labor administration relative to the local provinces (Knight & Song, 2005). Pay related issues (salaries and benefits) are currently stipulated by national labor laws as well as local labor regulations. In addition, local governments can devise their own regulations to suit local conditions (Cooke, 2011). This is in particular evident in the levels of minimum wage and standards of social benefits set across regions and cities.

Minimum wage regulations have been widely researched in economics and political science to examine their effects on employment with implications for employment policy development (e.g., Neumark and Wascher, 2007). Although the bulk of the research on minimum wage regulations rests at the national level, there are some studies that shed light on the relationship between minimum wage and firm behavior. Minimum wage is shown to have a negative impact on firm's export performance and human capital investment (e.g., Gan, Hernandez, & Ma, 2016; Haepp & Lin, 2017). Consequently, we expect sub-national labor regulation manifested in minimum wage setting to impact compensation practice.

The minimum wage regulation in China was introduced in 1994. According to this regulation local governments are responsible for setting and enforcing minimum wage standards (Fang & Lin, 2015). Minimum wage regulation became and remains the most significant regulation on wage issues in China. The very fact that China's minimum wage system has been sub-national in nature from the beginning of its establishment signals the significance of this regulation as a policy instrument for local governments to regulate sub-national labor markets.

The minimum wage system in China also captures the heterogeneity in institutional environment in the setting of executive pay. He and Fang (2016) argue that executive pay is set through an institutionalized process in which businesses respond to local social constraints to gain legitimacy and sub-national institutional differences can influence executive compensation. More developed provinces tend to have better functioning and more mobile executive labor markets (Cordeiro, He, Conyon, & Shaw, 2013). It has been shown that pay for performance sensitivity in executive compensation, i.e. the increase in executive performance as a result of an increase in pay, is weaker in firms located in less developed Chinese provinces (e.g. Conyon & He, 2014). Such a labor market condition may prompt firms to offer larger compensation so as to better motivate and retain their executives in more developed regions. In order to capture the variation in economic development across regions, we focus on minimum wage regulation. The setting and adjustment of local minimum wage considers, among other variables, levels of economic development across regions (Fang & Lin, 2015), which can influence compensation practice. The Labor Law of China in 1995 required that all enterprises should comply with paying local minimum wages and that sub-national governments should set the minimum wage according to five principles- local average wages, productivity, unemployment, economic development, and minimum living expenses. These conditions provide considerable flexibility to provinces and cities to set their minimum wage (Wang & Gunderson, 2011). We, therefore, argue that in China minimum wage best captures the core of sub-national regulatory institutions in terms of managerial pay related issues at firm level.

Decentralization in MNCs

In addition to institutional pressures discussed above, we draw on the global integration-local responsiveness framework (Prahalad & Doz, 1987) to acknowledge the potential influence of a firm-level characteristic—decentralization in MNCs—to understand when compensation practice varies across borders. MNCs face the dual pressure of pursuing a global vision while meeting local demands. The global integration pressure drivers MNCs to implement standardized practices across subsidiaries, and the host local pressures prompt foreign subsidiaries to adapt to host environments. It is imperative for MNCs to achieve a balance between these two sets of pressures while also facilitating worldwide learning within the organization (Bartlett & Ghoshal, 1989).

Decentralization refers to "the allocation of decision rights to lower-level managers" in foreign subsidiaries in areas such as human resource management or technology investments (Williams & Triest, 2009: 156). In decentralized MNCs, foreign subsidiaries have more scope to flexibly adapt their compensation practice and respond to local needs. For us, the multidomestic and the transnational type are especially relevant (see, Bartlett & Ghoshal, 1989). In the multidomestic MNC (low level of global integration, high level of local responsiveness), assets and capabilities are decentralized, and foreign subsidiaries have the autonomy and the decision-making power to exploit local opportunities. Similarly, in the transnational MNC (high level of integration, high level of responsiveness), the resources and capabilities are dispersed across the subsidiary network, which provides subsidiaries with more freedom to develop themselves while simultaneously being integrated into worldwide operations.

MNCs tend to align their HR systems, including compensation, with corporate strategy and structure (Taylor, Beechler, & Napier, 1996). Bloom, Milkovich and Mitra (2003) offer a typology of three approaches to compensation design which echoes the MNC types by Bartlett & Ghoshal (1989). Bloom et al (2003) show that MNCs with locally adaptive strategies commonly use a decentralized, multiple market approach in their compensation design. Like in the multidomestic MNC, this allows subsidiaries to develop unique compensation practices that meet the specific conditions of each local market. In contrast, MNCs that follow a global strategy typically design a unified compensation system across locations and subunits. Under such a centralized strategy, subsidiaries are compelled to implement HQ-transferred compensation practices with limited adaptation to the local context. The third type is in-between these two extremes and resembles the transnational MNC. While the MNC employs highly integrated compensation systems to facilitate the implementation of one global strategy, its subsidiaries are at the same time highly locally responsive allowing them to also tailor compensation practices at the local level. The typology offered by Bloom et al. (2003) suggests that decentralization in MNCs is integral to explaining the adaptation of compensation practice.

In summary, we expect to observe multiple paths to the adaptation of compensation practice as we consider the combinatorial influence of institutional (sub-national portability of skills and sub-national labor regulations) and organizational (MNC decentralization) conditions.

METHOD

In order to address our research question, we apply Qualitative Comparative Analysis (QCA) (Ragin, 2008; Rihoux & Ragin, 2009) to our study of the adaptation of compensation practice. QCA represents an ideal method for systematically comparing cases, because it treats each case as configurations of qualitative attributes rather than disaggregates them into analytically separate aspects (Fiss, 2009). It deals simultaneously with capturing complexity of interactions and attaining causality in patterns of activities for generalizability. Each case is represented by a combination of the presence and absence of these conditions, which in turn leads to a given outcome. We have identified, in the theoretical background, sub-national portability of skills, sub-national labor regulation and MNC decentralization as our conditions. We examine the combinations of these conditions under which adaptation of compensation practice occurs. This conjunctural causation sought by QCA differs from conventional statistical methods where causal effect tends to be investigated with independent variables. QCA permits multiple causations, i.e. different causally relevant conditions may combine in a variety of ways to produce a given outcome (Ragin, 2008). This is likely owing to the complementary ways in which balancing or contrasting institutions affect compensation adaptation. The other advantage of QCA is that it can embrace the complexity of case analysis and offer significant theoretical leverage so that generalization is possible. The QCA method is particularly suited for a small-N case study such as ours.

We adopt fuzzy-set analysis, a variant of QCA techniques (see Ragin, 2008; Schneider and Wagemann, 2012). Crisp-set dichotomizes a case as either belonging to or not belonging to a set. Fuzzy-set, however, allows for treating membership of cases with gradual degrees. A case cannot only be fully in or fully out of a set of conditions displaying the outcome, but also partially belong to a set. We are interested in the variations of adaptation of compensation practice across subsidiaries of MNCs, which is seldom an either-or issue. By applying a fuzzy-set QCA, we can capture partial adaptation of compensation practice, and avoid categorizing them as extreme cases.

Selection of Cases

The study included ten subsidiaries (i.e., case companies) of Finnish MNCs operating in China. The surge of Finnish investment into China from mid-1990s, especially after China's accession to WTO in 2001 (Kettunen, Lintunen, Lu, & Kosonen, 2008) presented an ideal setting in which to investigate the diffusion of management practices in Finnish MNCs. We contribute to the long-standing stream of research on the particular characteristics of MNCs internationalizing from small countries (Agmon & Kindleberger, 1977; Ghauri, 1992).

As a comparative method, an essential feature of QCA is to have as comparable cases as possible at the outset. By "controlling" extraneous "variables", different outcomes may be attributed to the conditions under investigation (Rihoux & Ragin, 2009). Therefore, the ten case companies were selected following the "homogeneous sampling" and "maximum variation sampling" strategies in case study research (see Fletcher and Plakoyiannaki, 2011:179). The parent companies of the ten cases had all transferred similar compensation practice which consisted of three main elements: salary standard, position grading, and bonus scheme. The bonus schemes could be used to compensate for any shortfalls in pay levels. The cases were all wholly-owned subsidiaries of Finnish MNCs, which eliminated the country of origin effect.

While the cases were similar in terms of the compensation practice transferred by the Finnish parent, they were sufficiently different in terms of the theoretically-derived conditions of interest, i.e. sub-national portability of skills, sub-national labor regulation and MNC structure. The sampling of cases commenced with the compilation of a list of Finnish operations in China from Finpro (Finnish Trade Promotion Organization). The list included 245 establishments located in Beijing, Tianjin, Shanghai and Jiangsu province and operated in various sectors such as manufacturing, banking, transportation and logistics, construction, fashion, research, trading, consulting and education. The outcome of case selection was the balance between theoretical consideration (variations in sub-national institutions) and homogeneity of subsidiary backgrounds. Among the cities we chose (Beijing, Tianjin, Shanghai, Suzhou and Wuxi), the minimum wages ranged from 800 yuan to 1000 yuan while the higher education attainment ranged from 12.87 per cent to 31.50 per cent, representing sufficient variation in sub-national labor regulations and portability of skills. To strike comparability, we included only manufacturing companies. We further eliminated, from the population, firms with fewer than

40 employees which is much bigger than the threshold of 15 employees set by the study of Björkman, Fey and Park (2007). This resulted in a sample of 47 firms, out of which 19 firms granted access. After checking the transferred compensation practice and MNC structure of the case companies, we finally selected 10 companies (out of the 19) that were located in cities with reasonable variation in sub-national institutions (labor regulations in minimum wage and higher education attainment) on the one hand and differed in their MNC organizational structure on the other hand. All of the sampled companies pursued the same compensation practice. Table 1 shows the details of the case subsidiaries.

Insert Table 1 here

As Table 1 shows, the ten case subsidiaries shared similarity in their background in age, industry, entry mode and function. The youngest subsidiary was five years old, hence had ample exposure to the host environment (see Björkman, Fey & Park, 2007). The parent companies were all headquartered in Finland. The oldest was established in 1910 and the youngest in 1974. The industrial sectors of the companies included metal, engineering, machinery, equipment, electronics and paper. Their international presence ranged between 28 and 56 foreign countries. Except for MetalCo and MacCo, all companies were publicly listed.

The case-oriented, small-N approach in QCA enabled a theoretically driven and an iterative process in case selection. The process was informed by the underlying research question and the preliminary assumptions of researchers, theoretical frameworks, and preliminary assumptions of researchers (see, Mahoney & Goertz, 2004).

Collection of Data

The data were collected from interviews, documents such as annual reports and internal policies of companies, laws and regulations at national and municipal levels providing information on minimum wage standards, and national census statistics (see Table 2). A total of 35 semi-structured interviews were conducted between 2008 and 2010 at the case subsidiaries in China. The interviewees were senior managers, functional managers and HR managers who had the necessary knowledge about compensation practice that applied to managers at their companies. The interviews lasted between one and two hours and were all transcribed verbatim.

Insert Table 2 about here

The interviews on decentralization and adaptation were complemented with documentary data of relevant Chinese laws and regulations at both the national and sub-national levels, as well as company documents such as HQ policy, annual reports, company presentations and organizational charts. The examination of relevant national laws served to confirm the scope of regional regulations concerning standards of minimum wage. The municipal regulations were found to have explicit standards on minimum wage and were used to code the condition regional labor regulations. HQ policy documents, company presentations and organizational charts supplemented interviews for instance in coding the MNC decentralization condition.

Calibration of Conditions and Outcome

We used the four-level scale following studies on MNC responses to internal and external environmental pressures (e.g. Crilly, 2011). The numerical values 0, 0.33, 0.67, and 1 indicate fully out, more out than in, more in than out, and fully in, respectively, in the set of causal conditions (Ragin, 2009; see also Crilly, 2011). One rater attributed values to conditions and discussed these with another project group member to validate calibration. There was an agreement on the calibration of all the conditions.

Sub-national portability of skills

We operationalized portability of skills at the sub-national level in terms of high-level formal educational qualifications, including the degrees that require a minimum of three years in higher education. This is a measure of general skills with theoretical content that is relevant for managers (see Estevez-Abe et al., 2001). In other words, a high percentage of high-level educational degrees indicates high portability of skills at the sub-national level, which requires less adaptation of compensation practice than low-education, including vocational, degrees. We used the higher education attainment as the measure for sub-national portability of skills. The case companies were all located in the east coastal area of China. We obtained percentages of population with higher education in nine coastal cities from the statistical yearbooks of respective municipalities. These statistics, which were based on the National Population Census of China in 2009, matched the time period of our data collection (2008-2010). The mean value of the nine cities was 18.35 per cent. This served as the crossover point of maximum ambiguity.

Insert Table 3 about here

As Table 3 shows, the case companies located in Beijing (31.50% attainment of higher education) were calibrated with a full membership value of 1. The cases located in Shanghai (21.95% attainment of higher education) were assigned a partial membership value of 0.67. The education standard of Suzhou is nearer to Tianjin than to Wuxi. Hence, we assigned a partial membership value of 0.33 to both Suzhou and Tianjin. Wuxi was assigned the full non-membership value of 0.

Sub-national labor regulation

We operationalized sub-national labor regulation in terms of minimum wage standards at the municipal level (Cordeiro et al., 2013; Fang and Lin, 2015). Similar to the calibration logic underlying portability of skills the sub-national level (higher education attainment), we relied on the minimum wages of China’s coastal area as an external standard. We drew on data from 2008-2009 to keep consistent with the qualitative interviews which were conducted mostly in this period. The municipal regulations on minimum wage standards were retrieved from Baidu (http://wenku.baidu.com/view/6a50f2aedd3383c4bb4cd236.html), the largest and most authentic internet search engine in China. The highest minimum wage was 1000 yuan while the lowest was 800 yuan. The mean value of 885 yuan was set as the cross-over point of 0.5.

Following Ragin's (2009) guidelines, we assigned the score of 1 to the cases located in Shanghai with a minimum wage of 960 yuan. Suzhou and Wuxi, with a minimum wage of 850 yuan, below the average of the ten coastal cities were assigned a partial membership value of 0.33. Tianjin and Beijing with minimum wage of 820 yuan and 800 yuan respectively were assigned full non-membership. Table 4 below summarizes our calibration.

Insert Table 4 here

MNC decentralization

We follow Bartlett and Ghoshal (1989) to conceptualize our organizational condition and draw on Williams and Triest (2009) to capture the condition of decentralization in terms of subsidiary participation in decisions over investment, market and product responsibility. We sought further evidence of this in interviews, annual reports and internal company documents. We assigned the subsidiary a full membership value of 1 where the decision making over investment and product development was decentralized in the MNC. A partial membership value of 0.67 was assigned where the MNC had strategic assets across subsidiaries and some degree of centralization. A partial membership score of 0.33 indicated that the MNC was largely centralized in the distribution of its strategic assets and resources. Table 5 shows the illustrative quotations and document extracts on the evidence used for measuring this condition.

Insert Table 5 about here

Adaptation

The outcome condition was calibrated with interview data collected from the case subsidiaries (see, Crilly, 2011). We drew on Taylor et al. (1996) to conceptualize the adaptation of compensation practices by subsidiaries. We regard adaptation of HQ compensation practice as subsidiary responses to host environmental demands. The condition receives a full membership (value of 1) when the subsidiary is primarily concerned with responding to the local conditions, hence substantially modifying HQ compensation practice. An example quotation is as follows: "The priority [in our compensation system] is to ensure the skills and competence we need for China operation. Now we have this kind of employee saving plan just for China, which is different from the Corporation. This is China-specific" (R&D Director of EngCoSZ). A higher partial membership score of 0.67 is assigned when the subsidiary engages in adaptive actions while also aligning, to some extent, with the MNC organization. An illustrative quotation is as follows: "When the unified practice comes from the top, we look at how it can be implemented here. We modify what is necessary while trying to maintain some standardized elements" (Business Director of EquCo1). A subsidiary that is primarily concerned with aligning with the MNC while adjusting HQ practice to some extent is coded a lower partial membership of 0.33. To illustrate, "we have global compensation which is implemented in all locations. We basically follow the same. Only in exceptional situations we make some changes" (HR Manager of ElecCo). A full non-membership score of 0 is assigned to the subsidiary for which alignment with the MNC organization is a priority; hence, no adjustment is made to HQ practice. An example quotation is as follows: "The corporate [compensation] policy is worldwide. We are part of the corporation and want to be consistent with the policy" (General Manager of EngCoBJ).

The assignment of fuzzy-set membership scores to the causal conditions and the outcome facilitated the construction of a matrix table of fuzzy-set membership (see Table 6).

Insert Table 6 about here

Using fsQCA 2.5 (Ragin & Davey, 2014), we first transformed the fuzzy-set membership scores in Table 6 into a truth table. There were five logically possible combinations, three for the positive outcome and two for the negative outcome. The truth table also contained three logical remainders that did not have real cases. Following the recommendation by Ragin (2009: 118), we chose 1 as the consistency threshold. As the number of cases is small, we chose 1 as the frequency threshold (Ragin, 2006).

We sought the necessary conditions before conducting the analysis of sufficient conditions in the adaptation of compensation practice. A threshold consistency score of 0.90, which displays the proportion of cases consistent with the outcome, was used to judge whether a condition was necessary (Ragin, 2006). Our analysis did not result in any necessary conditions.

We followed Standard Analysis of the software for identifying combinations of sufficiency (Ragin & Davey, 2014). This procedure can produce three solutions: a complex solution (no logical remainder is used), a parsimonious solution (all logical remainders are considered) and an intermediate solution (some logical remainders are included). The last solution requires the researcher to have substantive and theoretical knowledge about which logical remainders may be included in the analysis (Ragin, 2009). While government regulations are likely to create coercive pressures for foreign subsidiaries to adapt their practices to the host country environment, recent research has shown that foreign companies may circumvent or even shape host country institutions (e.g. Regnér & Edman, 2013). Comparative institutionalism suggests that a high portability of skills reduces the need for adaptation. However, the cases show that adaptation occurs in the presence as well as the absence of high portability of skills at the sub-national level. Therefore, one directional assumption could not be made for the conditions of sub-national labor regulations and portability of skills. According to the predominant view in the literature on MNC structure (Bartlett & Ghoshal, 1989), decentralized MNCs can grant subsidiaries autonomy for local adaptation of HRM practices (see, Bloom et al., 2003).

Based on the above-mentioned grounds, we present the intermediate solution (see Table 7). The solution exhibits an overall consistency score of 100 per cent, considered ideal for fuzzy set analyses (Fiss, 2011), and explains more than two thirds of the adapted compensation practices (73.97 per cent coverage). The complex solution is the same as the intermediate solution. The parsimonious solution is shown in Appendix 1. The intermediate solution is displayed in the Findings section and further elaborated thereafter (see, Ragin, 2009).

Insert Table 7 about here

We also performed the analysis of negative outcome (see Schneider & Wagemann, 2012). We obtained one intermediate/ complex solution ~mnc decentralization*~regional labor regulations*portability of skills, which suggests that centralization of MNC combined with lax regional labor regulation and high regional portability of skills is associated with non-adaptation of compensation practice. This additional analysis (furnished upon request) suggested that causation is not symmetric, i.e., the negative outcome is not explained by the reverse role of the same conditions as for adaptation.

Reflections on Doing Qualitative Research in China

One of the challenges of doing qualitative research in China is access to case companies. A personal relationship with an insider is often reported as a pre-requisite for gaining access (Tan & Nojonen, 2011). In our study, however, the case companies were approached directly without employing personal relationships and 40 per cent granted access which can be regarded as a good outcome of access negotiations. All but one contacted persons were senior managers including General Managers of the subsidiary or Presidents for HQ in China or the region of Asia. They initially accepted the interview request and further introduced the first author, who was responsible for data collection, to other interviewees. The successful negotiation of access can partly be attributed to foreign ownership, i.e. Finnish-owned subsidiaries operating in China. As Tan and Nojonen (2011) note, foreign firms tend to be more receptive to cooperation with researchers than Chinese domestic companies which lack the tradition of cooperating with academics and do not consider scientific research beneficial for their business. Accessing organizations through the top of the hierarchy mattered in the Chinese context even though the companies in question were Finnish-owned.

Access to companies was also enabled by a shared Chinese origin between the researcher and the interviewees, as it helped establish quickly close relationships with the Chinese interviewees (see Michailova 2004 on how her Bulgarian origin played a role in fieldwork in Russia). The first author was an overseas Chinese who had gained her PhD from a Western university and had specialized in HRM and cross-cultural management. She also had extensive practical work experience in Finland. Many Chinese interviewees were eager to learn about the best HRM practices and Finnish management culture. They saw the interview as an opportunity to acquire professional knowledge and enhance cross-cultural awareness. HR as a profession is rather new in China and Western HRM practices are often perceived as more “progressive” or “scientific” as one interviewee put it.

Mandarin Chinese was used as a shared language in the interviews with Chinese interviewees, which facilitated data collection. Although the interviewees were offered the choice between Chinese and English as the interview language, all but one preferred Chinese. The use of interviewees’ own language also facilitated insightful and rich conversations (see, Marschan-Piekkari & Reis, 2004). The younger interviewees spoke English better than the older ones. As one interviewee in our study commented, "[p]eople who are above 40 like me often don't speak English well." Many interviewees also resorted to mixing English terms such as recruitment, job interview, compensation, training, assessment tools, top management team with Chinese expressions in the interview situation, which may indicate an absence of many Western management concepts and practices locally.

Our experience also suggests that translating qualitative data from Chinese into English requires sensitivity to linguistic and cultural differences (e.g., Xian, 2008). For example, in Chinese, verbs are not conjugated according to tenses and personal pronouns as in English and many other languages. The temporal dimension is indicated by using adverbs and, in spoken Chinese, these modifiers are often omitted. In our study, the translation of the interviews by the first author who had conducted the interviews ensured consistency between the original data and its translated version. Another example is that the word 户口 (Hukou) can be translated as "residence registry". However, this word has a very different connotation in China vs. in Finland. The Chinese residence registry system is the product of the central planning regime that has tied people to their birth place and severely restricted the spatial mobility of labor and divided the population into rural and urban societies with different rights to access job opportunities and social welfare. The use of this term in our reporting required an elaboration to highlight its particular meaning in the Chinese context.

RESULTS

Configuration 1: MNC decentralization coupled with weak sub-national labor regulation and low sub-national portability of skills is associated with the adaptation of compensation practice

Our first configuration suggests that MNCs, despite low institutional pressures, still adapt their compensation practice to the local context. In our data set, three cases—EngCoSZ, MacCo and MetalCo—demonstrate the first configuration. For example, EngCoSZ was located in a smaller city, Suzhou adjunct to Shanghai. The differences in living standards and quality of life were remarkable. Shanghai served as a point of reference for job candidates in terms of work conditions. It was evident that Suzhou was in a disadvantageous position. As the R&D Director of EngCoSZ commented, "If we need a manager, an expert, or a specialist, our location is a challenge. It is difficult." The HQ-standardized salary policy was to apply the median salary level of the cities in which the subsidiaries were located. This practice underestimated the big difference in median salary between Suzhou and Shanghai. The variations in social standards posed a threat to EngCoSZ in terms of attracting and retaining talent. As a strategic unit of the Finnish MNC, EngCoSZ was responsible for manufacturing, R&D and the supply chain of the MNC. Yet, the HQs compensation practice did not reflect EngCoSZ's strategic role in the MNC corporation. The decentralized structure enabled EngCoSZ to adjust HQ compensation in response to local conditions. Apart from benchmarking its salary standard against that of Shanghai, EngCoSZ initiated some local elements. As the business director of EngCoSZ explained:

> The priority [in our compensation system] is to ensure the skills and competence we need for China operation that is part of our global strategy. We need the best people working for us… Our problem has been how to keep good people. Now we have this kind of employee saving plan just for China [in order to retain these employees].

The employee saving plan was a retention scheme for selected key employees based on the assumption that the employee stays with the company for an agreed number of years. EngCoSZ also emphasized coaching, training and career advancement for employees. Performance appraisal was an effective tool for identifying employee needs and for monitoring their personal development. This training practice enhanced the role of rewards in employee retention.

MacCo's challenge came from its location in Tianjin that had lower social standards compared to Shanghai. Both Tianjin and Shanghai are mega cities located in the east coast of China, the most developed region of the country. The relative difference between these two big cities resulted in a higher number of job seekers in Shanghai than in Tianjin. The difference in minimum wage between these two cities was 17 per cent. In addition, MacCo was situated in a district in the outskirts of Tianjin, about 40 kilometres from the central city. The district was a recent upgrade from an agricultural county to a municipality. The living standards and social life stood at stark contrast to the districts in the city. This intra-city difference also posed a challenge to recruiting managers and engineers.

MacCo modified the HQ practice of a pay rise. The yearly salary increase defined by the HQ was perceived by the subsidiaries as too low to meet the local labor market conditions. As the HR manager of MacCo noted, "The head office [in Finland] defined the policy that the salary rise could not exceed the inflation rate of the host country. So, the rise of salary has been some 3-4 per cent in the past." This increase, followed the official inflation rate, was much lower than the actual salary rise in China. The general manager of MacCo revealed, "The salary has been rising around 10 per cent yearly. In the past, the HQ set the rate of salary rise. For a couple of years, we have been giving a proposal and asking them to approve. They generally agree with our suggested rate." Additionally, MacCo provided key managers and professionals with subsidies for using personal cars and trains to commute to work. The transportation allowance became a local element in the compensation package.

The parent company of MacCo had three business areas with two product lines and a service function. MacCo was the strategic unit of Asia among other key units in Europe, America and the Pacific. The heads of such units were the members of the top management team at the HQs. While Europe and America were the mature markets, China and wider Asia were the key growth targets of the MNC. MacCo was the only international manufacturer of its sector that had the whole value chain— sales, production and maintenance services—locally present in China. The potential of this cutting-edge advantage of MacCo over its competitors could materialize only by building such a value chain. The decentralization in the MNC enabled the subsidiaries to adjust HQ compensation practices accordingly.

Configuration 2: High sub-national portability of skills coupled with tight sub-national labor regulation standard is associated with the adaptation of compensation practice

Configuration 2 suggests that in regions with high institutional pressures, the sub-national pressures alone are sufficient to explain adaptation of compensation practices. Four cases—EquCo1, EquCo2, EngCoSH and PaperCo—located in Shanghai had the highest minimum wage among the five cities in which our case companies were based. The high minimum wage exerted upward pressure on the general salary level. Shanghai was categorized as the first-tier city in China while all its surrounding cities were second-tier or even third-tier cities. The difference in median salary varied between 20 to 50 per cent among these cities. In addition, three of the four subsidiaries operated in sectors where labor turnover was higher than the average of all sectors. In an environment of highly portable skills and high salary standard, keeping pace with the market was crucial in maintaining competitiveness in employee recruitment. The strategy of EquCo1 and EquCo2 was to adjust the general pay rise to a level higher than the HQ standard. Salary increase for the managers was higher than that specified by the global policy. As the HR director of EquCo2 commented, “In the highly dynamic and fast changing labor market, we must closely follow the market trend in order to stay competitive in retaining employees.”

Apart from adjustments in salary, subsidiaries tried to integrate social benefits into their compensation package. Employers’ total contribution of social benefits (pension insurance, medical insurance and unemployment insurance, and housing fund in some cities) in Shanghai ranked the highest at the rate of 43.5 per cent of the salary among the five cities in the sample.

This level was regarded even higher than the Finnish level which was about 30 per cent. Adapting to the high standards of social benefits did not seem to be a problem for these case subsidiaries. It has to be noted that because the general salary level was much lower in Shanghai than in Finland, the absolute value of social benefits contribution was much less in Shanghai than in Finland albeit the percentage was higher. Social benefits standards did not only vary between regions but also stipulated some flexibility within the same region/city. The housing fund was a typical example. For instance, the minimum contribution by enterprises was seven per cent in Shanghai while the maximum was 22 per cent. Companies had considerable room to choose between these two limits, taking into account other components in the compensation package. For example, EngCoSH applied the maximum rate of housing fund for its employees. EquCo1 adopted a moderate housing fund rate above the minimum standard. Both companies had commercial insurance and a provision for health checks in the total compensation package.

Despite the adaptation of financial rewards, EquCo1 and EquCo2 acknowledged the importance of non-financial rewards as an extension to the compensation system. For example, the regular recreational activities organized at EquCo2 created and maintained close ties between the company and its employees as well as among the employees themselves. The general manager described, “We organize weekend outings outside the city from time to time. First, there is some light programme [entertainment]. Then, we sit down. People really open their mouths. They have a place to tell about their work, achievements and challenges. They feel that their work is recognized by peers, and they get a feeling of being rewarded.”

For EquCo2 the adaptation was to use differentiated rather than standardized position grading methods for the units in China. The China HR manager reported:

> The business units in China are complicated. A general manager of a small BU [business unit] may be equivalent to a middle manager or even lower manager of a large BU, but the

> small BU requires a general manager. So, we simply cannot use the standardized position grading system for all the units.

At EngCoSH, the emphasis in compensation practice was on achieving a balance between financial rewards and employee wellbeing. The HR manager commented,

> We cannot always use salary as a retention strategy. We don’t even want to. We keep our salary slightly above the market average. Then, we try to improve employee wellbeing by e.g., providing higher standard housing fund, extended medical insurance and some help to employees who have familial difficulties [which are not mandated by regulations].

Thus, the configurational approach allowed us to analyze institutional and organizational conditions in combination to better explain when foreign subsidiaries of Finnish MNCs in China adapted their compensation practices. We believe that our findings have important theoretical and practical implications to which we will now turn.

DISCUSSION

Previous research on the adaptation of HRM practices in China has typically examined the impact of institutional pressures at the national level (Marín, 2008). The emphasis has been on cross-country differences that tend to be explained from a global integration and local responsiveness framework. The way in which sub-national institutions influence HRM practices still remains unclear. The focus has rather been on how sub-national institutions can affect investment decisions and performance of firms (e.g. Meyer & Nguyen, 2005; Estrin et al., 2008; Ma, Tong & Fitza, 2013). In addition, studies on the adaptation of HRM practices have tended to examine host institutional/cultural factors and home country/parent influences separately, contributing to inconclusive findings on the effects of these drivers (e.g. Björkman & Lu, 2001; Gamble, 2003; Farley, Hoenig, & Yang, 2004). There is also the tendency to associate practice adaptation with decentralized MNC structures. It is assumed that such a structure provides subsidiaries with the necessary autonomy and flexibility to undertake adaptation (e.g. Bloom et al., 2003). In this study, we adopted fs/QCA to consider *sub-national* institutional and organizational conditions simultaneously to explain when adaptation of compensation practice occurs.

Our qualitative configurational analysis of compensation practice indicates that decentralization needs to be combined with lax sub-national regulation and low portability of skills for adaptation to happen (configuration 1). This is further confirmed by the parsimonious solution term 1 (Appendix 1). The lax sub-national institution would, in theory, suggest a low likelihood of adaptation. However, their association with the adaptation of compensation practice in our analysis indicates that MNCs, despite low institutional pressure, still adapt their compensation practice to the local context.

Our interviews reveal that the variation in salary levels and benefits between cities and provinces in China affects the availability of workforce and the size of the local labor pool. Subsidiaries benchmark their salary and benefits against the city with higher standards in order to enhance their image as an employer and to attract talent. The Chinese central government has streamlined administrative procedures and decentralized authority to local levels of government, to encourage outward foreign direct investment and regional development (Luo, Xue & Han, 2010). While national laws set out the principles and guidelines, the development of detailed regulations for implementing the laws lie with provincial or municipal governments (Cooke, 2011). The setting of minimum wage is a typical example. The sub-national differences in China are a manifestation of urbanization that is fuelled by economic reforms that have not been realized to the same extent across China. For instance, the regional difference in minimum wage reflects not only the gap in income but also the wider socio-economic conditions between provinces and municipalities. Sub-national regulatory systems are still under development, and there is a widening rift in the quality and availability of social services, education and leisure activity facilities across regions. By adapting to a higher standard of salary and benefits, subsidiaries contribute to raising living standards and social welfare in less developed regions.

At a more macro level, we argue that variations in sub-national regulations create normative pressure for subsidiaries to conform to higher levels of regulations than what is required by the city in which they are located (DiMaggio & Powell, 1983). This is contrary to the predominant view in international business that low institutional pressures encourage firms to evade local institutions or mimic HQ practices to reduce transaction costs. The basic assumption underlying this thinking is that institutions exert coercive pressures that constrain firm behavior (e.g. Buckley & Casson, 1976; Delios & Beamish, 1999). Instead, we argue that sub-national institutions may operate as 'residential communities' where firms are located in a defined geographical space and through their dependence develop a social identity (Freeman & Audia, 2006). The development of social identities in a sub-nation can exert pressure on other sub-nations to adopt stringent labor regulations (Greenwood, Díaz, Li, & Lorente, 2010). Firms under such pressure are inclined to learn from each other on how to become better at what they do or to minimize the competitive risk of losing a market or a source of supply (e.g. Güler, Guillén, & Macpherson, 2002).

Our second configuration highlights the adaptation of compensation practice within sub-national governance systems when subsidiaries face tight sub-national labor regulations and high portability of skills regardless of their MNC structure. High percentage of skilled labor, or high portability of skills at the sub-national level, encourages sub-national governments to use higher regulatory standards in wages and social benefits to leverage MNC activity. This points to the significance of sub-national institutions as enablers of adaptation by firms. It aligns with the arguments that sub-national institutions assume a central role in economic development in nations that have undergone a series of reforms and profound changes as in emerging economies. China's economic reforms—decentralization, marketization, and globalization—

have restructured the relationship between the central and local states and fuelled regional development (Wei, 2001). This finding is aligned with the comparative institutionalist argument that institutions offer resources that may be used by collective actors for particular purposes (Jackson & Deeg, 2008). As Fortwengel (2017) argues, institutional thickness—relative degree of multiplicity of support for a particular cause—can promote local institutional change and overcome 'deviant' behavior by MNCs. However, comparative institutionalists tend to make these arguments at the national level. In contrast, we deepen the institutional analysis by demonstrating that sub-national institutions can offer a locally insightful framework for exploring the dynamic interaction between MNCs and their environment. Local institutions can actively shape inward investment insidership or local embeddedness of MNCs to a foreign market (e.g. Monaghan et al., 2014). Municipalities, employers' associations and development agencies may 'institutionally experiment', building on or departing from elements of their national institutional arrangements to seek localized advantages (Almond, Gonzalez, Lavelle, & Murray, 2017). Such arrangements may take various forms of coordination with different emphasis on the role of local institutional actors. In China, as shown in our study, the key sub-national institutional actor is the local government who, via the regulatory mechanism and in collaboration with educational institutions such as vocational schools and universities, can (re)shape the local labor market, skills development and human capital. This government-centric form differs from capitalist economies where sub-national institutional coordination often involves a greater dispersion of power between local government, regional agencies, associations and trade unions.

The equifinality (same outcome associated with different configuration of conditions) attained in the study suggests that examining different combinations of compensation adaptation mechanisms may be a more fruitful way to advance our understanding than examining net effects (see also McGaughey & de Cieri, 1999). Even studies that reconcile the two competing pressures—global integration vs. local responsiveness—on adaptation of compensation overlook the intersection between configuration of firm-level conditions and institutional factors (Pudelko, 2005). They argue for the transformation of practices as they move across 'space' (Spicer, 2006), which has implications for the process of legitimating compensation practices in new settings. Institutionalists claim that the process of attaining legitimacy in a host context occurs at nested levels (Deephouse & Suchman, 2008). Hence, organizational conditions that are recognized and understood within widely-held cognitive structures of an institutional environment (Sanders & Tuschke, 2007) need to be considered in conjunction with host country sub-national regulatory and normative institutional conditions for an assessment of the legitimation of new practices. Our results also show under what conditions sub-national institutional pressures can trigger the adaptation of compensation practice in overly complex and rapidly changing emerging economies.

CONCLUSION

Our study demonstrates that MNC subsidiaries adapt their compensation practices for key managers and experts in regions with both weak and strong institutional pressures in China. In regions with weak institutional pressures, MNC decentralization facilitates adaptation. In regions with strong institutional pressures, the sub-national factors alone are sufficient to explain adaptation of compensation practices. These results point to the significant effect of sub-national institutions on adaptation of HRM practices in China. Although there have been calls to incorporate sub-national institutions into the study of adaptation of practices within MNCs (Almond, 2011; Monaghan, 2012; Almond et al., 2015), empirical research has remained at the national level (see, e.g. Myloni et al., 2004; Almond et al., 2006; Festing et al., 2007, 2013). We advance the impact of sub-national influence by uncovering how municipal regulations influence compensation practice based on a qualitative configurational analysis. This offers an insight into forms of agency by political and economic actors at local levels of governance as they attempt to influence the skills and human resources available for MNCs through regulatory means. Actors can experiment with local institutional arrangements by building on or deviating from national institutional arrangements to seek local advantages (Almond et al., 2017). This insight is significant as the impact of MNCs on employment and organizational practices in host economies are most keenly felt at local levels.

Although our study was conducted in China, we believe that our results have implications for Finnish MNCs operating in other emerging economies that share similar characteristics with China in labor market institutions in terms of regional differences in minimum wage and higher education attainment, such as Vietnam (Schmillen & Packard, 2016) and Russia (Ajupov, Kurilova, & Efimova, 2015; Smolentseva, 2007). Our chosen method—a qualitative configurational analysis—is well suited to offering this leverage. It enables control over unwanted causal inferences such as firm age, sector and mode-of-entry in cross-case comparison and deals simultaneously with complex interactions and causality in patterns of activities to achieve generalizability (Saka-Helmhout, 2011).

One limitation of our study is that the interviews solely covered subsidiary managers' viewpoints. Subsidiary managers might have over-emphasized the role of their unit or might have had a hidden agenda to promote their own interests. We attempted to mitigate this limitation by triangulating interview data with information from annual reports, company presentations, company websites, internal policy documents and organization charts received from the HQ of the case subsidiaries. Another limitation is that our study was based on the investigation on key managers and expert employees; therefore, the findings cannot be readily applied to other types of employees. A third limitation lies in the small number of conditions included in the model. In order to ensure the validity of our model, we had to consider the ratio of conditions to cases. According to Marx (2006), models drawing on 10 cases must include at most three conditions to reduce to likelihood of finding a model at random. Hence, we examined only three conditions – portability of skills in the region, regional labor regulations and MNC decentralization. Consequently, the explanatory power of our analysis of the adaptation of compensation practice is limited to these conditions. With the sampling of a higher number of cases that resemble each other in a sufficient number of features, more conditions can be added to the analysis to enrich the narrative.

Future research could be conducted to include other sub-national dimensions such as socio-economic development and cultural norms. In addition, it would be worthwhile to research further from where foreign subsidiaries draw their resources to respond to strong institutional pressures. Nonetheless, the configurations presented here offer an initial model for future studies. They challenge the common argument that firms in less established institutional contexts tend to mimic 'international best practice' (Aguzzoli & Geary, 2014). Lastly, an interesting direction for future research could be how sub-national institutions of a host country affect the HRM practices between different types of employees in multinational corporations.

Our study suggests that, in China, compensation practice is closely associated with employee retention. MNCs should carefully and continuously align their pay standard for managers and experts with the local labor market so as to remain competitive and attractive as an employer. In particular, MNCs that operate in smaller cities tend to face bigger challenges in attracting managers and experts. Foreign subsidiaries in China should be allowed to adjust the HQ pay standards with a high margin. Moreover, salary alone is not a decisive factor for employees to stay or leave. A good compensation package that consists of a balanced combination of various elements such as salary, bonus and benefits is important in China. Once compensation is aligned with opportunities for career development and training as well as work environment, employee commitment tends to be enhanced.

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Appendix 1. Parsimonious solution of adaptation

Configuration	*Raw coverage*	*Unique coverage*	*Consistency*
1) MNC decentralization	0.684543	0.264984	0.868
2) Sub-national labor regulations	0.630915	0.211356	0.801603
Solution coverage: 0.895899			
Solution consistency: 0.811429			

Cases with greater than 0.5 membership in term RLR: PaperCo (1,0.67), EngCoSH (1,0.67), EquCo1 (1,0.67), EquCo2 (1,1)

Cases with greater than 0.5 membership in term MNCDecen: MetalCo (1,0.67), EquCo1 (1,0.67), EngCoSZ (0.67,1), EquCo2 (0.67,1), MacCo (0.67,1)

Table 1. Summary of the case subsidiaries in China

	Case subsidiary (pseudonym)	*Age (year)*	*No. of employees*	*Entry motive*	*Function*	*Sector*	*Location (city)*
1	MetalCo	5	80	Market-seeking	Manufacturing	Metal	Suzhou
2	EquCo1	7	100	Market-seeking	Manufacturing	Equipment	Shanghai
3	CheCo	9	150	Market-seeking	Manufacturing	Chemical	Wuxi
4	EngCoSZ	10	600	Market-seeking	Manufacturing and R&D	Engineering	Suzhou
5	EquCo2	7	400	Market-seeking	Manufacturing and R&D	Equipment	Shanghai
6	EngCoSH	6	450	Market-seeking	Manufacturing	Engineering	Shanghai
7	MacCo	9	80	Market-seeking	Manufacturing	Machinery	Tianjin
8	ElecCo	10	780	Market-seeking	Manufacturing	Electronics	Beijing
9	EngCoBJ	5	100	Market-seeking	Manufacturing	Engineering	Beijing
10	PaperCo	7	280	Market-seeking	Manufacturing	Paper	Shanghai

Table 2. Summary of the data

Data collection method	*Amount of data*	*Content of the data*
Personal Interviews	35 interviews with business managers, functional managers and HR managers, ranging from two to four interviews in each subsidiary	HQ compensation practice, the extent to which compensation practice was adapted by the subsidiary, subsidiary autonomy in decision making, and company background information such as age, size and ownership.
Company documents	754 pages of annual reports, company presentations, company websites, internal policy documents and organizational charts	Organizational structure of sampled MNCs
Public documents	12 laws, regulations concerning wage and remuneration at national and regional level	Standards of minimum wage and social benefits of the cities
Statistical databases	The 6th Population Census of People's Republic of China (China National Bureau of Statistics, 2010)	Data of higher education in the total population of respective regions and cities

Table 3. Calibration of portability of skills at the sub-national level

City	*Higher education attainment (%) (population with higher education/ total population)*	*Calibration*	*Case*
Beijing	31.50	1	ElecCo, EngCoBJ
Shanghai	21.95	0.67	PaperCo, EngCoSH, EquCo1, EquCo2
Tianjin	17.48	0.33	MacCo
Suzhou	14.32	0.33	EngCoSZ, MetalCo
Wuxi	12.87	0	CheCo

Table 4. Calibration of sub-national labor regulation

City	*Calibration*	*Case*
Shanghai	1	PaperCo, EngCoSH, Equco1, Equco2
Suzhou	0.33	EngCoSZ, MetalCo
Tianjin	0	MacCo
Beijing	0	ElecCo, EngCoBJ
Wuxi	0.33	CheCo

Table 5. Calibration of decentralization and illustrative quotations

Case	*Interview quotes and extraction of documentary data*	*Calibration for fuzzy- set QCA*
MetalCo	Our China manufacture is one of our foreign operations in the group company. We run our local operation very independently. The technology development is also based on local markets. For example, here we have a technology team that designs products suited to China. (General Manager)	1
CheCo	Our mother company decides these things [investment and market development]. This kind of issues have to be considered at group level. Local subsidiaries modify the design to each country, like we do in China. (Vice president, China)	0
PaperCo	In our sector, an investment is a huge sum and long-term investment issues are centralized. Of course, local units give our voices in e.g. local market prospect and product development. Like us, we make proposal on these for China. (China Business Director)	0.33
EngCoSZ	We have been quite decentralized, meaning subsidiaries of local companies enjoy high degree of freedom in making decisions, business models and types of customers. However, we do have a number of standardized processes [e.g., IT process, employee information system]. (HR Director, Asia Pacific)	0.67
EngCoSH	Our corporation has been quite centralized. For example, the issues we decide at China team have to be approved by the HQs (Vice President, HR, China) We have had a lot of expatriates sent by the HQs. My opinion is that two third of them should be replaced by local Chinese. (Vice President, China)	0.33

EngCoBJ	We rely on our group company for a lot of resources, for example, capital for investment and technology. The decisions on these issues are normally taken by the headquarters, like the target country for investment and the core of technology. (China President)	0
EquCo1	The MNC organization had three diverse business lines. Each country offered unique service programme for customers. Business decisions were made at country level. (Company annual report and website)	1
EquCo2	We need local expertise knowledge in our research and development. Although our parent in Finland plays an important role we cannot have everything done there. We need a kind of flow of knowledge. As for key investments, head office in Finland is the key player, but subsidiaries are involved actively in the process. (President, Asia)	0.67
ElecCo	We do have some flexibility in the kinds of products for local market. For example, we have recently adjusted our production lines to other electronics products due to the market situation. (HR Manager)	0.33
MacCo	Our group company has an overall strategy, broad directions and targets. The operational issues are based on local markets. In product and technology development we work together with Finland and other countries. (General Manager)	0.67

Table 6. Fuzzy-set membership of conditions and outcome

Case	*Sub-national portability of skills*	*Sub-national labor regulations*	*MNC decentralization*	*Outcome: Adaptation*
MetalCo	0.33	0.33	1	0.67
CheCo	0	0	0	0.33
PaperCo	0.67	1	0.33	0.67
EngCoSZ	0.33	0.33	0.67	1
EngCoSH	0.67	1	0.33	0.67
EngCoBJ	1	0	0	0
EquCo1	0.67	1	1	0.67
EquCo2	0.67	1	0.67	1
ElecCo	1	0	0.33	0.33
MacCo	0.33	0.33	0.67	1

Table 7. Intermediate solutions of the positive outcome: adaptation

Assumptions: MNCDecen (present)

Configuration	*Raw coverage*	*Unique coverage*	*Consistency*
1) MNC decentralization*~ sub-national regulation*~portability of skills	0.369085	0.212934	1.000000
2) sub-national labor regulation* sub-national portability of skills	0.369085	0.422713	1.000000
Solution coverage: 0.791798			
Solution consistency: 1.000000			

Cases with greater than 0.5 membership in term sub-national labor regulation*portability of skills: PaperCo (0.67,0.67), EngCoSH (0.67,0.67), EquCo1 (0.67,0.67), EquCo2 (0.67,1)

Cases with greater than 0.5 membership in term MNC decentralization*~ sub-national labor regulations: MetalCo (0.67,0.67), EngCoSZ (0.67,1), MacCo (0.67,1)