

Global Industrial Practice

Succeeding in China:

Best practices in overcoming the war for talent

SpencerStuart

THE WAR FOR TALENT

With a population of 1.3 billion people, many view China no longer as an emerging market but rather as a market of necessity. So much already has been written regarding the strategic importance of China and what is driving its rapid and unprecedented economic growth over the past 20 years — the massive number of consumers, the continuous expansion of the urban market, the increasing rate of disposable income and the opening up of free trade and foreign investments.

And while industrial companies view the explosive market as either a core component of their globalization strategies or as a low-cost location for sourcing, practically all businesses agree that China is pivotal in the race for capturing a global advantage. The challenges of doing business in China, however, are plentiful. The somewhat underdeveloped infrastructure makes it difficult to distribute products across the wide expanse of regions. Unclear regulations, protectionism, dealings with joint venture partners and government involvement are perceived as obstacles to establishing new businesses. In addition, cultural and language differences abound. Nevertheless, these are trials that likely will dissipate over time as experts predict that by 2020 China will become the world's second largest economy.

Yet given all of this optimism surrounding China, our clients are telling us that the greatest obstacle facing them is talent.

The Chinese marketplace only has been open for approximately 20 years, resulting in a shortage of senior and middle managers who can operate in a market economy. In addition, the companies that have invested in talent management have been able to reap some rewards, but they also have become a training ground for their competition as they recruit away this talent.

“And while there is a huge population in China, the subset of individuals who have the language skills and the necessary business experience is a much smaller number, and they are being actively pursued,” said Alexander Cutler, CEO of Eaton Corporation, a diversified industrial manufacturer with annual sales of \$8.1 billion that first entered China in the mid-1980s with license agreements.

“Talent is our most singular challenge,” said John Stang, vice president of global sales for Kennametal, a multinational material and tooling supplier to the mining and construction industry that has been in China for more than 10 years. “It is extremely difficult to attract and retain quality people. The market is so hot, that good people can do whatever they want. I firmly believe that, if an organization can solve the people issue, they can manage the other potential problems around the language, culture and infrastructure.”

PUSH FOR LOCALIZATION

Over the past two decades, the majority of industrial companies entering China relied heavily on

expatriates to manage local operations. Expatriates brought a strong understanding of the company culture to the region and in-depth management skills, and, as a result, were better able to connect with headquarters. However, within the past three to four years, multinationals began to see the benefit of revamping their human capital approach.

Localization of talent is now central to their business strategy. The push for localization stems from a convergence of trends, including the increasing cost considerations associated with expatriates; the need for local market and cultural understanding in the management of locals; better market penetration among the regions to meet growing consumer demand; language capabilities; and, just as important, being recognized as an employer with successful local management and a demonstrated commitment to China.

Yet few companies are truly successful, as the need to localize talent can outstrip quality measures, never mind that the development of local talent has been slower than anticipated in meeting multinational standards of performance. There is a severe shortage of experienced managers, thus creating a war for talent that is making the development and retention of a skilled workforce extremely difficult.

The first step to winning the war for talent in China is to understand the type of professionals that equate to success. The degree to which companies struggle with finding the right balance between hiring local talent and expatriates will

depend on the maturity of their business in China and their strategic priorities.

THE TALENT DEMANDS OF DOING BUSINESS IN CHINA

One of the most important skills for senior managers is the ability to understand the Chinese culture and be able to effectively communicate with the different constituents in the native language. No matter if the executive is from China or from outside of the country, talent based in China also needs to have experience working in other countries. “Cultural differences do exist, but adapting to the Chinese culture does not have to be difficult if you have learned how to deal with people from other countries. That is why, for executive positions, we are seeking individuals who have lived and worked abroad, with a strong track record of respecting other cultures,” said Dr. Bernd Leissner, president of Volkswagen China Group, which opened its first representative office in Beijing in 1985 and has since established many joint ventures between foreign and Chinese suppliers. Formerly, Dr. Leissner was the president of Volkswagen in Asia Pacific from 2002 to 2004 and president of its Mexico division from 1995 to 2002.

“We need people who understand how to establish organizations in China, with a strong understanding of the issues related to operating in a foreign country,” said Steve Chapman, vice president of international and president of the inter-

national distribution business for Cummins, the world's leader in the manufacturing of large diesel engines. Chapman, who speaks fluent Mandarin, began his career with Cummins in 1985, where he was involved with significant license agreements and joint ventures. During this time, he also lived in Singapore and China.

In addition to having strong international experience, executives must have an extremely solid business education. For Tenaris S.A., a \$3-billion global manufacturer of steel tubes and related services, mainly for the oil and gas industry, this education is key. "Because we are increasing our presence in China, we must hire internationally educated people who have strong business experience. These are people who will be capable of taking on increased levels of responsibility as our business grows," said Luis Albaine, regional human resource director of Tenaris, which has manufacturing and finishing facilities in South America, North America, Europe and Asia. Tenaris has been a leading supplier of tubes into the Chinese market since it opened a commercial office in Beijing in 1990.

The importance of partnerships — dealing with the Chinese government, state-owned enterprises and private owners — also plays a crucial factor in determining the type of person who will succeed in China. An executive who is a good negotiator, especially at creating joint ventures, and can manage government and partner relations is at a premium. "We need people who have a good background in working with the Chinese

people and organizations. They have to understand the importance of partnerships,” said Chapman. “For us, our policy has been to license and operate joint ventures in China so that we can manufacture the product locally in order to gain strong market share — something we couldn’t capture through imported product alone. And while I think this is a more effective approach, we also need to ensure we have the right people in place to negotiate and then manage these important deals as an equal partner.”

Eaton’s Cutler also stressed the critical importance of forming strong relationships with the regional governments. “Many of our executives who have been trained in the U.S. or in Europe tend not to think about the government as an integral part of what they do every day. Our executives in China need to understand that they’re going to spend 30 to 40 percent of their time with government officials,” he explained.

From a functional perspective, many industrial companies are seeking experienced marketing executives and engineers. As a result of the rise in disposable income, favorable government regulations and the WTO ascension, the Chinese demand for automobiles has skyrocketed. Today, 75 percent of passenger automobiles are sold to private customers, whereas three years ago the sales primarily were fleet and government-related sales. For Volkswagen, which has been in Shanghai for 20 years, tapping into this demand requires executives who are skilled in sales and marketing. “We are seeking marketing people

with very different industry backgrounds, such as telecommunications, TV, mobile communications — those sectors where new technologies and new products are introduced to the market every six months or so,” said Dr. Leissner. “We need people who are intellectually capable of reacting quickly to rapidly changing market conditions.”

According to Cutler, whose company has 21 offices and plants throughout China, the availability and skills of engineering talent has changed greatly over the decade. “Today we tend to find outstanding engineering talent,” he said. “Ten years ago, much of the engineering talent didn’t have the luxury of growing up in a mechanically based culture. As a result, their academic training was extraordinary but the practical application of their engineering skills was slower to mature than their counterparts in Europe and the U.S. This is no longer the case. In addition, China is graduating nearly 10 times as many engineers as the U.S.”

FINDING THE BALANCE BETWEEN EXPATRIATES AND LOCAL TALENT

Knowing the types of skills and business experiences required of executives working and living in China is the first step. The second step is determining the best mix of talent. Because the demand for local Chinese executives who fit the ideal profile is greater than the current supply, industrial companies doing business in China have to take various approaches to their human capital needs.

“If you are a local Chinese, speak fluent English, and possibly another European language, and have a competency in a specific function, you are a highly valuable person. And, if you were to add one or two other functions or general management experience, you could write your own ticket,” said Cutler.

The balance between hiring local Chinese, which is contingent on availability, and bringing in expatriates also depends on the business requirements and the relationship between the Chinese operations and headquarters. “You have to hire someone that upper management is going to trust, and that requires someone who can communicate with the head office. To do this, it really helps to have worked in the U.S. for a period of time,” said Chapman. “For example, we have a director who is an American, but speaks Chinese and has 12 people working for him, nine of whom are Chinese. In some situations, I think there will always be a need for expatriates in certain roles — especially area geographic heads. We will require more seasoned people; but, hopefully, many of our current leaders who are from China will be able to grow into these roles.”

In the case of Tenaris, a company that has started to expand its operations in China beyond the initial commercial activities, it is using both expatriates and nationals. “We started by sending expatriates with significant industrial knowledge and have begun forming the new management structures by searching for Western-educated professionals of Chinese origin. At the same

time, however, because of localization, we understand the importance of cultivating the local workforce, so we will also focus on building entry-level programs with the hope that, in a few years, we will have a good layer of local people,” said Albaine.

But for those more established industrial companies, the ultimate hope is to rely heavily on local talent. Stang, who has 24 years of global sales and marketing experience with Ingersoll Rand prior to joining Kennametal in 2004, is working toward this same strategy. “Developing the right skill-set is critical to any business and China is no exception. When we hire great people, we also have to train them,” said Stang, who is responsible for building the Asia Pacific team for Kennametal.

Industrial companies, almost universally, understand the importance of training when it comes to hiring local talent. Eaton approaches this by identifying high-potential performers in China and then bringing them to Europe or the U.S. to learn the business before going back to China. Volkswagen takes a similar approach. “We are extremely attracted to Chinese nationals who have completed university and have additional education from outside of China,” said Dr. Leissner. “Once they have completed their education, we will train them over a period of 12 to 15 months to help them adapt to the Volkswagen culture and then send them back to China. We select only the best, those who we feel are capable of adapting to a foreign culture. We cur-

rently have about 40 to 50 Chinese professionals in special training programs in Germany.”

Another strategy companies are beginning to employ — rather than just rely on expatriates or local talent — is to pair the expertise that each executive brings to the position. “I usually try to send a pair of people into a new entity or joint venture — be it an expatriate and a local Chinese executive — who have complementary strengths,” said Chapman. “For example, we have a Chinese general manager who is brilliant when it comes to negotiating joint ventures and dealing with the partner and the government, but he knows very little about manufacturing. We paired him with one of our manufacturing leaders, who in turn did not know anything about China, but he had a great reputation for managing in diverse environments. The combination will ultimately depend on the specific business need.”

Eaton has adopted the same strategy, pairing an expatriate with a local executive. “When it’s a senior-level role, we need someone who has credibility with headquarters so he or she can act with authority. And while you can give someone that responsibility on paper, it’s very different to have it in practice,” added Cutler.

HOW TO ATTRACT TOP LOCAL TALENT

Once companies determine the right combination of expatriates to local talent, the next challenge is to determine the best way to attract local

talent in China. “In addition to the growing demand for these executives, the country’s infrastructure also makes it difficult to attract talent — long commute times, location of plants, long work hours and heavy traffic,” said Stang.

“For Eaton, it’s been difficult to get people to move back to the remote areas of the country,” said Cutler. “Talent is moving to the coast at a rate of almost two million people a week — that’s almost eight million people a month that are moving from the mid or western part of China to the eastern coast. But the majority of manufacturing will be located in the middle part of the country, so we’re trying to get the talent that we need to move back. It’s not easy. The availability of people with multinational experience, who are getting two to three offers every week, makes this a big challenge.”

One of the most important assets a company can possess when it comes to attracting talent is its reputation. “A large company can steal away the best talent by paying an exorbitant amount of money. That’s why the company’s reputation is very important in China. In addition, big brand name companies tend to have an advantage in terms of attracting talent. That’s why we have our own corporate relations team continuing to work to strengthen our brand in China,” said Cutler.

Compensation also is a major factor in attracting talent in the country. However, because competition for talent is so fierce, industrial companies purposely are trying to keep salaries in check

while ensuring that they are competitive, including Tenaris, explained Albaine.

“At Cummins, our typical strategy is to pay at about the 50th percentile; it’s our global approach. However, given the demand for talent in China, at the moment we’re going through a study to determine if our salaries are in line. Until then, we might have stock options and other benefit packages for high-potential people and will occasionally provide completion bonuses that will pay out over a four-year period,” said Chapman.

“Going beyond compensation, we have to help our people understand that there’s more opportunity with us than simply the opportunities in China. This involves working very hard at increasing their levels of responsibility and accountability,” added Cutler.

KEEPING YOUR TALENT AWAY FROM THE COMPETITION

While recruiting the best talent can pose a challenge, the retention of these executives remains a major concern among industrial multinationals.

“One of our top challenges is the retention of good people,” said Chapman. “We have a really solid foundation of people and we’ve hired a lot of up-and-coming executives and have been developing them for a number of years; but the market for people is so ultra-competitive in China that we’re always worried about our competitors taking

away our people. We've actually targeted certain people and given them a type of retention package just to get us over a particular hump. However, I think the most important aspect of retention is having a good work environment and giving people opportunities. If people feel they are in an environment where they can take some risks and feel empowered, they are more likely to remain with us."

Career development, going forward, will be critical in the war for retaining top talent. At Kennametal, the company invests in training to improve skills and to help with retention, but Stang conceded that increased skills do not necessarily impact people's interest in remaining with the company — and that it's very difficult to build loyalty when employees have such short tenure. "In order to stop the outflow of talent, we utilize stay-on bonuses as we do not want to pay salaries that are over the market norm," said Stang.

At Volkswagen, they try to address retention during the hiring process. "We generally don't hire people right out of university because we find that the turnover rate is too high. Almost everyone we hire in China has an M.B.A. in addition to international experience," said Dr. Leissner.

THE TALENT LANDSCAPE IN 10 YEARS

Given the number of challenges still surrounding the recruitment, management and retention of local talent — coupled with the narrowing cost

gap between expatriates and locals — more and more industrial companies are acknowledging the need to have an organizational mix of local talent and expatriates.

“If you don’t understand the country, it’s hard to hire people from that country. Start with trying to develop relationships, hire somebody who has a good international background to start with and who has been demonstratively successful and have them take on that market and begin building that foundation. Then, bring local talent into the company and have them start cultivating relationships so that they understand the company culture,” recommended Chapman.

“In 10 years from now, probably 90 percent of all management positions at the Volkswagen China Group will be occupied by Chinese executives who speak English and/or German and who have been educated in the U.S. or Europe,” said Dr. Leissner. “However, there are differences between those who were born and educated in China compared with those who were born and educated outside of the country, and these differences need to be recognized when putting together a management team. Executives need to have a broad base of knowledge and must have succeeded in several different functions and positions. While training the Chinese can be a somewhat lengthy process, there is plenty of young, smart and ambitious talent available.”

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