LEADERSHIP DISRUPTED

The challenge for multinationals in China.

ODGERS BERNDTSON

Introduction.

It might be a cliché to reiterate that multinational companies (MNCs) are facing huge disruption related to rapid technological advancement, changing client expectations, regulatory pressure and a constantly shifting competitive landscape. That challenge is compounded when that MNC is trying to break into a market as complex, changeable and multifaceted as China. Then, it will have to confront all of the localisation, regulatory and technological challenges present in other markets, and then some.

One might argue that it might not be worth entering into China at all for the medium size MNCs, let alone the "relative" small ones. The truth, though, is that in today's economic environment, most MNCs cannot afford wasting the potential of an enormous market in China.Hence the right question is: what are the keys to mitigate the risk and eventually succeed in this enormous – and notoriously difficult – market?

Odgers Berndtson interviewed China-based executives from more than a dozen multinational companies across a variety of industries to ask them what they see as their biggest challenges and opportunities and to share their leadership strategies for the future.

Their advice is to have realistic expectations of China's market opportunities and competitors, to implement structure and discipline in local operations, and to trust in local talent. What is clear from our conversations with these leaders is that companies that equip themselves – with adequate research and preparation and the right people – to meet the challenges of this unique market head-on, have a greater chance of success.

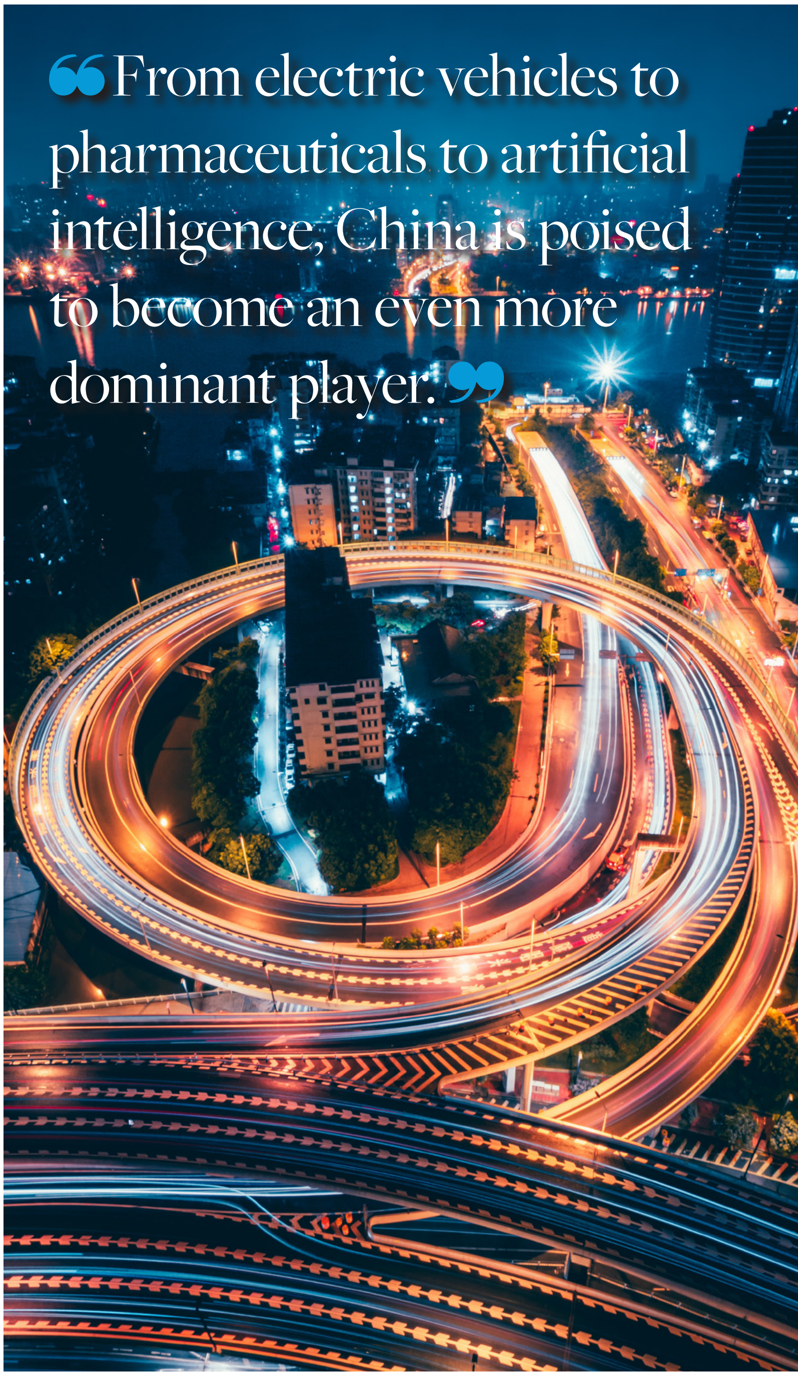
Setting the scene.

China is an economic powerhouse and an emerging global superpower. Based on GDP at purchasing power parity, China's economy is ranked number one in the world by the IMF, overtaking the US, and the country has the population size and the ambition to keep widening the gap. China's 1.4 billion-strong population, its production efficiency and intensity, and capital investment have combined to drive China's impressive economic growth.

Although it has recently encountered pan-Asian competition from the US government, President Xi Jinping's ambitious Belt and Road initiative will boost China's economy and extend its cultural influence even further with land and sea foreign infrastructure investment projects reaching as far as Western Europe and Africa. In addition, the government's Made in China 2025 initiative is focused on upgrading the country's industrial and high-tech sectors with the aim of making China the world's leader in technology.

These two initiatives are both threats and opportunities, not only to foreign countries, as evidenced by the reactions of various governments and international organizations, but also to the MNCs which operate in these countries. Nevertheless, from electric vehicles to pharmaceuticals to artificial intelligence, China is poised to become an even more dominant player.

As the president of a London-listed engineering company told us, "the Belt and Road initiative and the Made in China 2025 policy have increased focus on the development of advanced manufacturing capability and are accelerating the maturity of the Chinese market." For multinational corporations, The Red Dragon has long presented a cultural and operational challenge, but it is also too large and powerful a market to ignore.



Industrial revolution.

China's economic and industrial transformation over the past few decades from mass production to high quality manufacturing has proceeded at an unprecedented pace. The CFO of a printed circuit board (PCB) manufacturer reflected, "China has gone from being the 'workbench of the world' to a world technology leader. And now Chinese companies want to be seen as equal partners, not as cheap labour with production capabilities." The CEO of a multinational manufacturing company added, "China is now advancing quickly towards intelligent manufacturing and local governments are supporting businesses in this effort."

In addition to changing the way Chinese companies view themselves, the government's success in bringing about this transformation has changed the way Chinese citizens view themselves and their future. The head of digital for a multinational bank explained, "Recent rapid economic growth has made the Chinese very positive about the future and has increased their faith in the government. This has produced a fervent nationalism where before there was an admiration for all things Western."

Of course, this rapid transformation also requires European and North American MNCs to adjust their understanding of the Chinese market to match the new reality. An executive at a US-based biotechnology company explained, "MNCs have for a long time thought of China as a centre of manufacturing. Now that China is an innovation centre and in a leading position in the world, MNCs need to change their mind-set." An executive at a semiconductor manufacturing company headquartered in Europe counselled, "Even old China hands that have spent their whole careers here will fail if they do not adjust their thinking."

Pressures and challenges.

One of the unique challenges associated with doing business in China is how fierce the competition from local companies can be, a phenomena that the MNCs often overlook. Even though Starbucks opens a new store in China every 15 hours (that is 11 per week), the head of digital for a multinational bank shared, "MNCs have to constantly watch their flank. For example, Starbucks' challenger Luckin Coffee opened 525 stores in just nine months and was recently valued at US$1 billion. Luckin offers an all-digital experience: you order on an app and your coffee is ready in five minutes. As a result, Starbucks is feeling the heat in its second largest market."

The president of a London-listed engineering company concurred: "Chinese companies are nimble and very quick to respond to the development of new technologies. In addition, IP enforcement is still not strong enough in China to protect MNCs, although this is changing now that Chinese companies are coming up with many of the new technologies!"

One of the most topical events this year is the settlement of the ZTE case. (The world's fourth largest telecoms network equipment maker had been found guilty of breaking US export control laws.) The unexpected consequence as a result of the saga is that MNCs will be more protective of their IPs, and Chinese companies, backed up by the government, will pour unprecedented resources to build their own IP. The competition between local Chinese companies and MNCs is likely to intensify for the foreseeable future.

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The regional president of a multinational industrial conglomerate agreed that a key challenge for MNCs is competing with local companies, some of which, like Huawei and Xiaomi, are becoming MNCs themselves. He noted, "When there are technological breakthroughs, local players are very quick to adapt, while MNCs are not nimble or responsive enough. Local players have a very strong fighting spirit."

In addition to being quite aggressive and speedy, local competitors also benefit from a significant home field advantage.

A banking executive elaborated, "China is often spoken of as an uneven playing field and it's true that MNCs operate under a more complex and restrictive legal framework than their Chinese counterparts. When you have to run every decision up the chain of command, it's difficult to react quickly. Chinese companies, on the other hand, take an 'act first, apologize later' approach. As Jack Ma, founder of Alibaba, was quoted as saying, 'by the time the government says it is ok to do it, it is already too late'."

This is not entirely true, but it is what is felt by many MNCs when they operate in China. The reality is that, even under the same regulatory and legal framework, enforcement on local companies and MNCs is vastly different.

The president of a London-listed engineering company explained another way in which the competitive landscape is shifting to make things more difficult for MNCs now than in the past. "Twenty years ago, the Chinese government courted foreign companies. Today, foreign investment is still needed, but there are new sources of cash from a more mature Chinese private sector. There are even some sectors where local companies get support from government, which gives them an advantage."

An executive at a semiconductor manufacturing company headquartered in Europe agreed: "It is harder now for MNCs than it has been in the past. The speed at which companies like Huawei are able to change strategy, develop and roll-out new products gives MNCs a very high bar to clear."

Keys to success.

All of the China-based executives we spoke to agreed that understanding and adapting to the local market is the key to succeeding in China. The regional president of a multinational industrial conglomerate put it succinctly: "Solutions produced in Europe or North America will not be effective here." It is indeed true that "One size doesn't fit all" and you will have to have a tailor-made approach in China if you want to survive.

An executive at a European semiconductor manufacturing company echoed this advice: "MNCs should follow, to the extent they can, local business practices and strategies. If companies don't deviate at all from the policies set by their global headquarters, they will fail in China."

The regional president of a multinational industrial conglomerate concurred: "MNCs that don't understand the local culture and simply roll out global policies will struggle. For example, building relationships and trust (with employees and business partners) is very important in China and should be prioritized. Trust helps managers control costs and facilitates faster decision making."

Coca-Cola, KFC (operated by Yum China) and Apple were called out by an executive at a US-based biotechnology company as MNCs that are succeeding in China, thanks to their success at localizing their product offering. The CEO of a multinational manufacturing company added Wal-Mart to that list, noting that they sell live fish in their Chinese stores. An executive at a US-based biotechnology company agreed: "The mistake MNCs make is to believe that if something works in the rest of the world, then it will work in China. Companies need to focus on responding to local customer requirements."

Seeing the world differently.

There's no question that China's unique business culture – which includes concepts like face in the sense of reputation, honour and social standing (miànzi) and the importance and influence of personal connections (guanxī) – can pose challenges for outsiders. As one executive at a multinational manufacturing company advised, "Western leaders need to listen to what is not said, rather than to what is said." This may sound like a Chinese proverb, but achieving this level of understanding begins with a long-term commitment to the market and a willingness to learn, grow and adapt to a new culture.

A U.S. semiconductor development company executive noted, "Everything about China – its market, people and consumer behaviour – is unique. Understanding both the culture and how Chinese government policy is evolving is critical to success. Therefore, it is necessary to have executives based in Shanghai or Beijing in order to know what the market really wants."

Importantly, what the market wants is not uniform throughout the country. The CFO of a PCB manufacturer explained, "China is actually many diverse consumer markets requiring the localisation of both products and services. MNCs need to understand China region by region and to tailor their offering accordingly."

In addition to being extremely large, the executives we spoke to stressed how fast moving the Chinese market is. The PCB executive continued, "China is a massive market and it is important to be able to scale up quickly in response to fast-changing consumer trends. Chinese consumers expect and adopt the very latest technologies (like 5G) faster than anywhere else. As a result, companies need to have a very solid online business strategy and a holistic online to offline commerce model."

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The CEO of a multinational health care provider echoed this point, noting, "the Chinese market moves more quickly than the rest of the world" and demands that services be "accessible, mobile, immediate and consumable in ever-smaller chunks." A semiconductor development company executive concluded: "Half of the MNC leaders in China are making a concerted effort to learn fast, take advantage of new technology and keep abreast of market trends. Companies that don't make the effort, or are unable to learn, will die a natural death."

Undoubtedly, MNCs that understand China's culture, market and consumers have a much better chance of success.

Closing the gap.

So all MNCs have to do to crack this giant market is adapt to a completely foreign culture, understand a plethora of different but connected consumer groups, and move at breakneck speed to keep up with technological developments and changing demand. Easier said than done.

Reassuringly, the MNC executives we spoke to in China report seeing more cultural overlap in recent years, thanks to the globalization of business and the increasing openness of the Chinese market. An executive at an American semiconductor company observed, “Recently there has been some convergence in the way Chinese and Western people see the world, but it will take more time to fully close the gap. Cultures do not change overnight.”

The CEO of a multinational manufacturing company agreed that business culture in China is beginning to shift as “companies are increasingly adopting a more global perspective.”

Undoubtedly, the two business cultures are moving closer together, but there is still a considerable gap to close between China and the rest of the modern, globalised world. While it will take some time to close the gap, it is most important that MNCs understand the gap, and play their role in closing it.

The Chinese MNC leader.

Given that localisation and cultural adaptation are the keys to succeed in this unique and challenging market, it’s no surprise that the executives we spoke to emphasized the importance of local leadership. An executive at a biotechnology company counselled, “MNCs should bring more local talent – voices that really understand the market – into their decision making process.”

The same executive conceded, “There are some competence gaps for local executives, particularly related to communication skills.” “But,” he argued, “from a technical and business perspective they are as strong as any other leaders.”

An executive at a manufacturing company headquartered in Europe agreed, noting, “The capability of local executives is improving and they are better at understanding and reacting to the local market than Western leaders. In addition, they tend to be more flexible than their Western counterparts and are better at challenging [old ways of thinking] and reaching for big opportunities.”

He also pointed out a downside to this optimism, however, noting, “Chinese executives can be over-confident about what they can achieve, compared to leaders from more mature markets who tend to be more humble and conservative. Chinese executives want to be able to do everything on their own.”

The CEO of a multinational manufacturing company elaborated further, “The successful MNC leader in China is more global and less insular in their thinking and understands the importance of process and discipline, instead of only focusing on results. Unsuccessful leaders operate by the seat of their pants or sequester themselves in their offices instead of actively participating in the business.”

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Two of the executives we spoke to observed that Chinese leaders tend to be more focused on growth rather than long-term profit. The CFO of a hi-tech manufacturer said, “The Chinese leader may have a broader strategic picture and longer-term targets, but still wants to see quick wins and gains along the way.”

He continued, “Chinese leaders are “doers, not talkers” and aim for speed rather than perfection. They thrive when they are in control of the business and can give clear directions and targets to the teams below them, from whom they expect nearly immediate execution.”

The regional president of a multinational industrial conglomerate noted that while “Chinese leaders are very quick to see opportunities and react to them” they are also “keen to maintain a rigid hierarchy.” He explained, “In the West, leaders are more open to discuss issues and challenges and to embrace diversity and display empathy.”

Undoubtedly, finding the right mix of local knowledge, business acumen and international experience is a challenge. Once the right local talent has been identified, however, an executive at a biotechnology company observed that “Chinese executives working in MNCs want to be treated the same as everyone else and not passed over for promotions by Western executives shipped in from HQ.”

The Chinese employee.

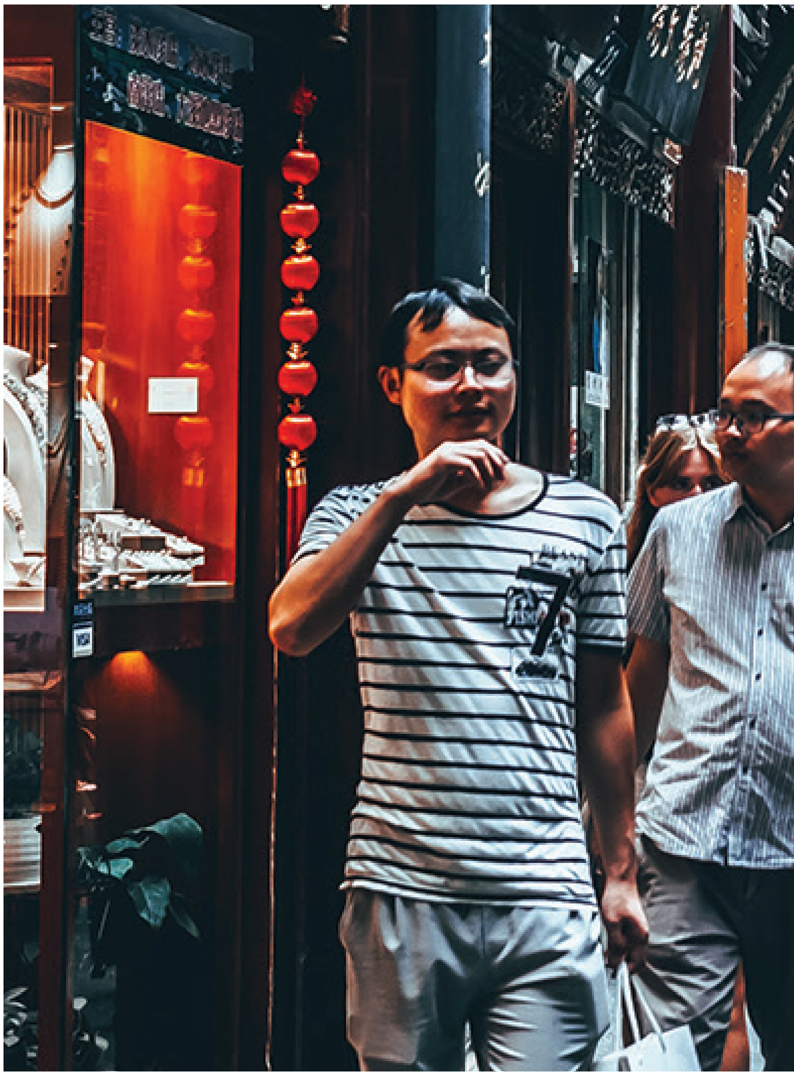
One of the biggest challenges MNCs face in China is how to develop and retain talent. Chinese employees are hardworking and enthusiastic and, as the regional president of a multinational industrial conglomerate noted, they "are eager to learn, adapt and change." The CFO of a hi-tech manufacturer added, "Chinese employees are very good at fast execution, combined with a high degree of flexibility. Therefore, strategic changes can be easily implemented at short notice."

Still, cultivating employee loyalty can be difficult as Chinese employees are more willing to jump between jobs in order to achieve a higher salary. The regional president added, "The best people want to work for the big Chinese players where they are paid more and have more power. When they decide to come back to Western MNCs, they want to earn the same money and have a better work-life balance."

The CEO of a multinational manufacturing company counselled that the key to cultivating loyal employees is to help them grow with the company. "We need to find ways for people to develop a career rather than just have a job," he noted.

Cultural differences also pose a challenge. In terms of their attitude at work, the CEO of a multinational health care provider described Chinese employees as "deferential". The regional president of a multinational industrial conglomerate concurred, noting, "Their mind-set is not to challenge the leader. Chinese employees focus on pleasing and building a good relationship with the boss over everything else." An executive at a US-based biotechnology company explained, "Chinese employees are used to a hierarchical structure, with clear levels of seniority and responsibilities."

An executive at a semiconductor manufacturing company headquartered in Europe observed one downside of this deferential attitude: "Chinese employees don't want to take risks or stand out from the crowd." Still, Chinese employees are excellent team players and like anywhere



else, teamwork and discipline are critical to running a business in China. An executive at a US-based biotechnology company noted, "Chinese teams will achieve miracles if they are given a clear goal."

Notably, just as the Chinese market is very large and diverse, the VP of a electronic component manufacturer points out that employers may encounter "significant differences in employee expectations towards their employer and different working styles, depending on which province you are in."

Summing up the winning strategy, a U.S. semiconductor company executive advised, "Create a great product or service, cultivate a strong local leadership team and empowered employees, so the company can react quickly to market demand, and execute well." Get three out of three right and you can succeed anywhere.

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Getting it right.

More than ever, succeeding in China as an MNC requires a lot of tenacity, flexibility and investment. As the VP of an electronic component manufacturer cautioned, "Companies need to have a realistic understanding of the operational realities and true business opportunities in this market. MNCs can still win big in China, but money isn't being made as easily as it was 10 years ago."

Research and preparation, a long-term outlook and cultural adaptation are the key. Emphasizing the importance of proper research, a multinational manufacturing company CEO advised, "MNCs need to do their due diligence on potential JV partners and on any other companies they are considering doing business with."
Another manufacturing executive concurred: "If companies decide to join forces with a local company, the partner needs to be picked wisely and the foreign management team needs to really understand how to make best use of their partner's resources. A purely western management approach won't work with a Chinese partner."

A senior executive for a multinational bank echoed this view: "MNCs must form partnerships with local players and fund them to fight." An executive at a US-based biotechnology company added, "Many companies hesitate to bring R&D and innovation into China. They need to have local R&D operations to succeed."

A longer-term outlook is also essential for success. The regional president of a multinational industrial conglomerate noted, "MNCs have to invest in the Chinese market to succeed. Typical Western business goals – like the obsession with quarterly results – are too short-term."

In terms of cultural adaptation, the CFO of a circuit board manufacturer observed, "MNCs need to understand the Chinese way of doing things. Playing by the written – and even more important, unwritten – rules and demonstrating support for government strategies and policies will be rewarded." An executive at a multinational manufacturing company added, "Doing the ground work, getting into the local culture and business practices, and hiring the right people is the winning formula." This would be sensible advice in any market, but it's indispensable wisdom in China.

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MORE INFORMATION

This focus on China follows the release of a new Odgers Berndtson report, called 'Leadership, Disrupted', produced by Mark Braithwaite, Managing Director of Odgers Berndtson, APAC. The report is based on 70 face-to-face interviews with APAC leaders of multinational companies.

The full report is available on the Odgers Berndtson website.

ODGERS BERNDTSON IN CHINA

Since 2004, Odgers Berndtson, China has been partnering with our clients addressing the business and cultural challenges identified in this White Paper.

We have delivered outstanding results for large multinational companies, niche players, start-ups and non-profits across all industries in China. Today, the ability to unite traditional business practices with global markets is the hallmark of the exceptional executive. This is particularly true as Government policy shifts towards innovation and openness. It is clear that both domestic and international organisations must embrace new technologies and outside investment if they are to continue to grow and compete in the coming years.

Odgers Berndtson works with domestic and international firms to balance the need for international experience with relevant cultural expertise, across their senior leadership team. Each of our Partners have more than twenty years of consulting experience, with a focus on providing strategic management services – from executive search and assessment to organisational structure review. In addition, we are always able to call on the international reach and expertise of the Odgers Berndtson network of 60 offices across 29 countries.

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James moved to China in 1990 leading start-up businesses in software and entertainment. He started his executive search career as a Partner at Heidrick & Struggles, establishing their China business in 2000. He was then a Partner for Korn/Ferry International in Melbourne, before joining a local boutique firm in 2011. While in Australia, James served on the Victorian board of the Australia China Business Council for nine years. He returned to China in 2015 to establish the North Asia practice of a tech-focused boutique.

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