

The big picture  
**Offshoring evolves and grows**

1 ■■

Offshoring  
A GLOBAL PERSPECTIVE 2 ■■

IIC PARTNERS SELECTS BRIGADIER  
GENERAL AS COO 4 ■■

THE WAR FOR TALENT  
The fact overtakes the fad 5 ■■

# The big picture: Offshoring evolves — and grows

With John Morton, IIC Partners

***More things are tradable than were tradable in the past, and that's a good thing.***

— N. Gregory Mankiw

Industrial production has been migrating to locations of comparative advantage ever since the Industrial Revolution. As economists make clear, offshoring is business as usual. But they've also warned that, with the technologies of the 21st Century, changes will likely be faster and more far reaching than ever before.

Offshoring — and the search for senior managers to lead such ventures — has also been very much a learning process, says John Morton, Chicago-based leader of the Industrial Practice Group for IIC Partners, Executive Search Worldwide.

"The United States has long been a net exporter of industrial manufacturing," Morton says. "In the '90's, the hot topic was NAFTA (the North American Free Trade Agreement) and the movement of production to Mexico.

"As we fast forward, the region that has been the benefactor of production export — from all industrialized nations — has been Asia, specifically China. India has also done very well as an importer of jobs, but most notably in service sectors.

"Companies that have placed factories in Mexico are currently reassessing their total cost structures and the availability of talent," Morton says. "The newest area

of interest is Eastern Europe. Quite a few companies are assessing costs and capabilities within that region and moving businesses or parts of businesses there.

"The key issues for companies interested in moving production capacity," Morton says, "all centre on the management of the global supply chain and the co-ordination of material/components, scheduling, manufacturing and then shipping of products globally. Companies have gone to a total-cost model and have found that when all costs have been taken into account — material, labor, shipping and cost of storage — outsourcing production to certain countries, for export back to home markets, does not make as much economic sense as once expected. China has recently changed their VAT tax structure, which has caused even more analysis on true total cost.

"These companies are now focusing — and sizing — their offshore production for that offshore marketplace and close surrounding countries," he says. "They're decentralizing production — and limiting the associated risk — rather

***In the 1980s, we were worried that Central America was going to go communist. Now we are worried it is going to go capitalist?***

***Thomas L. Friedman***

than packing up lock-stock-and barrel.

"The biggest change within senior management search for offshoring organizations is that they're moving away from placing expatriates into overseas assignments and moving very quickly to hiring country nation-

als for their key senior roles in off-shore operations," Morton says. "This trend has been driven both by cost as well as cultural management issues."

Put simply, Morton says, high-cost expatriates statistically come with a higher failure rate than lower-cost local hires. The local manager likely speaks both English and the language of workers on the production floor and can learn the corporate culture of his or her new employer far more quickly and effectively than an expat can learn to fit into the Czech Republic, Romania or China.

Besides, he notes, leading industrialized nations aren't really in a strong position to export large numbers of senior people to overseas positions where their chances of success may be doubtful, at best.

"The senior leadership pool is ageing in the United States and Western Europe and many executives are close to retirement. After the lean years of the '80's and '90's, when middle management was drastically reduced, the current depth of senior ranks is very thin.

"Companies are relying on their search consultants as never before to patch holes in their domestic talent pools, as well as to provide very solid links into any number of offshore economies. At IIC Partners, we've seen

# OFFSHORING

## A global perspective

IIC member firms around the world confirm the picture of richer countries moving production capacity to emerging nations, while individual companies constantly refine offshoring strategies.

this as a doubling of the pace of our transborder business, frequently when clients in leading industrialized nations ask us to find local managerial talent in countries where they're setting up new production facilities."

So far, Morton notes, relatively modest eastward movements of production capacity and capital investment have had profound and generally positive affects on living standards in receiving nations, though the environmental record has been mixed, at best.

"Whether you believe increased prosperity in China, India and Eastern Europe will make the West richer or poorer is the big political question," Morton says. "Historically, I think it's fairly clear that a rising economic tide lifts all boats to some degree.

"The pressing business question is whether the world has the executive talent to manage a world economy that will be much larger in ten years," he says.

"In light of the rapidly shrinking executive talent pool across all leading industrialized nations, I think we need to start building solutions now. As just one example, an industrial producer with offshoring plans might consider searching out leadership talent in the target country now, hiring those people and bringing them to the home office for training and mentoring before sending them back to lead new operations." □

**John Morton is President of New Directions Search of Chicago and Industrial Practice Leader for IIC Partners.**

Switzerland, long the recipient of offshore banking, is now a significant exporter of industrial production. More than half of 112 leading Swiss companies responding to a recent survey indicated they already have operations in Eastern Europe, Latin America and Asia.

"We show the same pattern as all or most industrialized countries," says Urs Wüthrich, the Zurich-based former chairman of IIC. "A lot of manufacturing has been moving eastward. A couple of years ago, this was to Eastern Europe and, over the last two or three years, mainly to China.

"This survey showed that 70 per cent of Swiss offshore ventures were successful, Wüthrich says. "But success was rarely dependent on reducing wage rates alone. The authors of the survey said, 'Optimization must encompass the whole value chain and not just wage costs.' "

In Vienna, IIC member Gottfried Dissauer says Austria is now an exporter of manufacturing capacity. A European Manufacturing Survey for May 2006 showed that 51 per cent of responding Austrian manufacturing companies have moved some part of their production to other countries, particularly in Eastern Europe.

"Manufacturing in Austria is decreasing because of relatively high loan costs," Dissauer says. "Multinational companies have been relocating their production facilities from Austria to Eastern European countries or to the Far East. Some still hold their competency centers in Austria, such as Siemens and Lafarge, due to high quality

standards for technical education in our country.

"Schindler has recently talked with us and our IIC colleagues in Bratislava about hiring needs around the expansion of their production facilities there," Dissauer says. "Similar to Siemens and Lafarge, they're keeping their competency centre in Vienna. Also, as more production moves into Eastern Europe, Vienna is emerging as a hub for this activity, with investments in roads and rail transport and increased flight connections both east and west."

IIC Industrial Practice leader John Morton of Chicago notes, however, that the success of receiving countries is tending to have a leveling affect on their economies and particularly their wage rates, rapidly reducing their comparative advantage.

Spain, for instance, is transitioning from importing to exporting production and jobs, according to IIC member Luis de Ugarte.

"I would say the most relevant change in the manufacturing sector in Spain over the last 10 years is the increase of competitiveness," Ugarte says. "The profitability levels of Spain's manufacturing enterprises have reached, if not surpassed, the EU average. There has been economic growth, due to a more qualified labour force, availability of capital and gradual specialization in mid- to high-technology products," he says.

"As Spain picks up the pace of industrialized countries, its focus towards delocalization (offshoring) follows the first-world trend. We are beginning to export production capacity eastward."

A recent study of the Spanish economy, by professors Luis Torrens and Jordi Gual, shows the typical pattern of a maturing economy, with rising wages and peaking productivity. The study concludes that Spanish sectors most likely to pursue offshoring strategies include transportation equipment, followed by electronic equipment, plastics and rubber products.

Receivers of industrial capacity have two things in common — relatively cheap labour and large, underdeveloped markets or proximity to such markets.

In Romania, local IIC member Radu Manolescu, says two additional factors have helped to make his nation a destination for manufacturers on the move.

“We have good technical schools and, thus, plenty of good engineers,” Manolescu says. “And the government offers incentives for industries to locate in areas of high unemployment.”

But he says incentives have been a double-edged sword.

“FDIs (foreign direct investments) are seen as a benefit for the areas they go into — they have a reasonably good environmental record and they often build additional infrastructure or upgrade what is there. But building infrastructure is a cost for businesses and this lack of infrastructure speaks to another issue, which is the expatriate question,” Manolescu says.

“The ex-pat issue is indeed maybe one of the biggest issues,” he says. “Companies sometimes send lots of people and if the area they are located in is poor, you can imagine — they come and go every Monday and Friday. It’s certainly an important benefit to airlines. But it’s a cost for the company.”

“The alternative is local talent but the very good Romanians are ‘rara avis.’ They are like diamonds and thus very expensive. Sometimes companies prefer to hire expats from France, Italy and Austria, because in some cases it’s

cheaper than some local talents.”

The current darling of industrial offshoring is, of course, China, with a population of 1.3 billion, an annual gross domestic product of \$7.043 trillion US and a runaway GDP growth rate of 11.4 per cent in 2007.

With those figures driving it, China attracted foreign direct investment of some \$75 billion in 2007 alone. And, for the most part, business has been good for newcomers. The U.S.-China Business Council and the European Union Chamber of Commerce say that more than 80 per cent of responding members reported their China operations were profitable in 2006.



“Surveys show that two-thirds of foreign-invested enterprises in China are profitable,” says Paul Lien, Beijing-based partner in PCI Executive Search and a core-team member of the IIC Partners global Industrial Practice Group. “Government statistics indicate that from 1990 to 2004, foreign investors in China remitted a total of \$250 billion (US) in profits.”

“China now represents not only a fast-growing source of revenue for many multinational companies, but also a rising source of profit,” Lien says. “China has become the world’s biggest market for cellphones, with more than 500 million wireless subscribers and the second-biggest market, after the U.S., for personal computers and cars. It also accounts for a huge share of the global

demand for commodities such as iron ore.”

He adds, however, that there is growing awareness of the social cost of such explosive growth and signs that businesses will be expected to shoulder their share of the burden. A revised Company Law of the People’s Republic of China, in effect since January 1, 2006, says that in addition to pursuing profits, companies and their shareholders must also bear social responsibilities.

“The growth in manufacturing has led to serious environmental degradation, worker safety problems and periodic bottlenecks in China’s supply chain of strategic materials, especially oil and industrial metals,” Lien says.

“Issues include poverty, health care, education and even the provision of clean water. Leaders doing business in Asia must now balance the short-term expectations of their global investors against addressing these broader long-term challenges. The issue of corporate social responsibility is now gaining widespread recognition and becoming a necessity for most companies.”

At the same time, a white-hot economy presents predictable business challenges.

“The most common scenario is when foreign investment rushes into the country for any of the emerging market segments,” Lien says. “Scarce local talents become highly spoiled by so many job opportunities coming all at once. This situation increases the demand for expatriates and returnees from abroad (local Chinese with foreign education and work experience), as alternatives to the domestic labour market, especially among companies in the early stages of development, after initial entry into China. Expatriates do not have the language skills that are essential for a significant portion of the management team, while returnees are highly sought after.”

If China has been the latest sweet-heart of the offshoring phenomenon,

surely India has become the bogeyman. As a legacy of its British colonial past, India has inherited an English language school system — and with it the ability to offer not only cheap manufacturing labour but also higher-value services.

***“The issue of corporate social responsibility is now gaining widespread recognition and becoming a necessity for most companies.” — Paul Lien, China***

In post-industrial Europe and North America, it has been a shock to see white-collar jobs migrating from Boston to Bangalore to be done for lower wage rates and all-in cost savings variously estimated at 30 to 40 per cent. Nor has this movement of jobs been confined to customer-service call centres. What began with ‘captive’ call centres for American Express and British Airways nearly two decades ago has transformed first into business process outsourcing (BPO) to third-party Indian companies and most recently into (information technology) IT-enabled outsourcing operations such as payroll processing, data processing

and data mining by third-party Indian companies or by joint-ventures with Indian companies.

Software engineering has become a huge sector in India, while several companies have moved certain legal, bank-

ing and accounting activities there. But IT skill also raises the level and value of manufacturing that can be done in India.

“The introduction of high technologies into manufacturing makes it necessary to source from a country that can provide high-tech skills and this is where India offers comparative advantage,” says Keyur Thakore, a partner of KTA Associates in Mumbai and a member of IIC. “India’s expertise in skill-intensive manufacturing sectors, such as auto components, pharmaceuticals and textiles gives it an edge over other low-wage producers.”

With a population of more than 1.1 billion people, gross domestic product of \$2.9 trillion (US) in 2007 and an estimated economic growth rate of 8.5 per cent for the past two years, India attracted direct foreign investment of \$67 billion in 2007. And the World Factbook of the US Central Intelligence Agency reports that in the past decade India has reduced the number of people living in poverty by 10 percentage points.

Thakore says that by some calculations, India’s manufacturing exports alone have the potential to grow by as much as 17 per cent per year and to reach \$300 billion by 2015. □

***With files from IIC Offices in Zurich, Vienna, Madrid, Bucharest, Beijing, Shanghai and New Delhi.***

## IIC Partners selects Brigadier General as COO

PARIS — IIC Partners, Executive Search Worldwide has hired former brigadier general Martin Vine of the UK as its new chief operating officer.

In a global search, Vine was selected on the basis of his proven international leadership skills, his record of consistent achievement and because he impressed IIC Board Members with his relentless optimism, said IIC Board Chair Martine Bournerias of Paris.

“Martin is the executive we need to lead a rapidly growing global organization, ranked among the top 10 search groups in the world and focused on raising our international profile,” Bournerias said.

“We’re a diverse group, with 55 offices in 41 countries and we felt Martin’s impressive record in challenging international assignments would fit very well with our objectives for the future of IIC. His job will be to help us build revenues, attract the highest-quality new members, deliver valuable services to clients and



Martin Vine, COO, IIC Partners

members and maintain our momentum in all these areas.”

Vine said his immediate priorities are to get to know the 150 partners in the organization, learn their goals and aspirations for IIC and deliver on achievable early objectives.

He said his early military career was fairly traditional, including battalion command responsibilities, before he

moved into international assignments.

From 2005 to 2007, he was defense adviser to the British High Commission in Islamabad, Pakistan, where his duties included co-ordinating UK military support to earthquake relief in 2005. Previously, he commanded 2,000 troops from 18 nations with the Multinational Task Force in Bosnia. In Iraq, he served as deputy for security to the Coalition Provisional Authority during 2003-04. Earlier, he was assistant military attaché to the British Embassy in Washington, D.C.

Vine is a holder of the Order of the British Empire (OBE) and the United States Meritorious Service Medal.

“Martin has a record of getting things done in complex, multi-national situations,” said former IIC chairman Urs Wüthrich, who directed the COO search. “He’s pragmatic, diplomatic and goal oriented and we think that’s a rare combination of core skills that’s essential to success in a member-driven, global organization such as ours.” □

# THE WAR FOR TALENT

## THE FACT OVERTAKES THE FAD

With Paul Dinte

Vice Chair, IIC Partners



The largest and most lasting damage caused by the Enron debacle is happening right now, says Paul Dinte, a director of IIC Partners, Executive Search Worldwide.

Enron's failure wiped out billions of dollars of investor equity in 2000, demolished both itself and the venerable accounting firm Arthur Andersen and — most importantly — heralded the end of the First War for Talent. Enron was the foremost exponent of the "War for Talent" (as first promoted by McKinsey & Co.) and the company's stunning collapse signalled, in many minds, the concomitant bankruptcy of the talent-war philosophy.

"The Second War for Talent — the struggle for corporate survival — is under way right now and we need to use what we learned in the first war to fight smarter the second time around," Dinte says. "The war isn't over, it's only beginning and the McKinsey people got it right when they said there is no final victory. It's an ongoing struggle."

That's why, he says, the U.S. subprime mess is no time for retrenchment. "The talent shortage is a huge demographic issue that won't just go away. Some businesses will cut back on recruiting — no doubt — but that makes it a great opportunity for strategic players to gain ground by sticking to a plan that addresses the longer-term talent prob-

lem."

This time the war is not a matter of executive narcissism and self-indulgence, as in the Enron case. This time it's being driven by the common demographics of the leading OECD countries.

World War II ended some 63 years ago and the first ranks of the ensuing massive boomer generation are now entering retirement. Senior positions, typically staffed by senior people, are being hit hardest and the executive suites of America and Europe are expected to turn over half their incumbents in the next five years.

The trailing cohorts of workers — generations X and Y — are far smaller than the boomer generation. As a result, several tens of millions of existing and newly-created positions are expected to run vacant in the decade ahead. Many of those will be executive talent positions made all the more difficult to fill because of the 1990s War on Middle Management (better known as downsizing). And this impact was exacerbated by the 1990's value shift that discouraged company loyalty as part of the downsizing effort.

A decade later, Dinte says, the abrupt course reversal has given the world economy whiplash.

Propelled by the emergence of a huge new middle class out of the educated proletariats of India and China, the

global economy is demanding workers at all levels. In the industrialized nations of Europe and North America, the demographic sea change is just beginning and already companies are struggling to find the people they need. The number crunchers say in the years ahead the US and European economies could run many tens of millions of workers short.

"The first priority in the war for talent is to define what you mean by 'talent,'" says Dinte, who is the founder and CEO of the executive search firm Dinte Resources, in Washington, D.C. "We tell our clients that talent is not a commodity. It's a serious strategic mistake to talk about talent as the sum total of all the workers you need. We urge clients to fill rank-and-file positions with the best people available at the moment and move on.

"Talent is rare and valuable," Dinte says. "Save the talent search for the few positions with the power to shape the company — the leadership team and their direct reports.

"Use a search firm, because the really good people are hard to find, harder to attract and tend to expect serious approaches to be made through search firms.

"When we talk about talent, though, we also caution our clients to avoid a star system, like the one at Enron. Enron grabbed what they called talent, from all

the best schools and by the dozens, paid those people lavishly and gave them free rein. Some of these ‘talents’ created whole business units without executive authorization. Whatever that is, it isn’t teamwork.

“The job of an executive search firm should be to find the person with the skills and experience you need, who has the personality, motivation and ethics to fit well into your leadership team and corporate culture.”

At the same time, Dinte says, there should be some very selective hiring of a few talented graduates or other junior people who have real potential to play big roles in the future. “There’s something fundamentally wrong with a company that doesn’t grow a significant portion of its own talent — just as there’s something wrong with a company that can’t attract and retain new blood.

“Clearly, though, a big part of winning the war for talent is the defensive struggle to keep the good people you have,” he says.

Retention strategies that are helping some companies include:

- Development of a recruiting brand or identity;
- Differentiating by work/life balance, social responsibility, environmental performance, and other genuine company values;
- Increasing training budgets at all levels;
- Creating small, entrepreneurial business units offering opportunities for big impact and rewards;
- Cultivating a reputation for good leadership;
- Mentoring high-potential employees.

Whether the search for talent is in-

ternal or external, Dinte says, it should never be allowed to degenerate into an IQ contest, as it did at Enron. “IQ correlates rather poorly with long-term job performance and IQ measures don’t include any teamwork factor.

“It’s cheaper to retain good people than to replace them,” Dinte says. “But when you need new senior talent, those people are going to be increasingly hard to find in the decade ahead. In this environment, competitive advantage goes to those who can search farthest and fastest and who can consistently attract and retain the best people. Building a strategic relationship with an accomplished executive search firm should be the first step.” □

**Paul Dinte is the founder of Washington, D.C.-based Dinte Resources Inc. and IIC Partners Vice Chair for the Americas.**

## Profile: Hohauser provides global link

For more than twenty years Harvey Hohauser & Associates has provided executive search services to companies around the world. Named as one of the best retained executive search firms in North America, our patented seventy-eight-step process has resulted in more than 600 successful searches. As the IIC affiliate in Michigan, they now have increased capability to serve their clients in more than 50 markets worldwide.

IIC Partners was formed in Europe during the mid-1980s, anticipating the needs of internationally competitive companies to access a world-class executive talent pool serving the emerging global economy.

Today, IIC is placed among the top 10 global search firms by revenue, with more than 50 offices worldwide, providing instant access to 40 leading nations.

A global matrix of independent search firms, IIC members are leaders in their local markets. They employ best practices to ensure consistency and excellence in every assignment.

Client service is based on three core capabilities: Local Knowledge; Industry Expertise; Global Reach.

Local Knowledge  
No matter how widely you search, local

knowledge is indispensable in the hunt for executive talent.

You need search professionals who know the languages, the cultures and the facts behind the headlines of the relevant local markets. You need the acumen of experienced professionals working on their home turf.

Each IIC office is an independent business, run by professionals with years of experience in their home markets.

### Industry Expertise

It’s essential to work with consultants who have a comprehensive knowledge of your industry – locally, regionally and globally. You need search professionals who understand your industry, your corporate culture and the special skill sets vital to strategic positions in your organization. You need search consultants who know where to find the talent to match your needs.

IIC partners maintains and constantly develops this vital sectoral expertise through eight practice groups:

- Automotive
- Consumer & Retail
- Financial Services
- Life Sciences
- Board Search
- Energy
- Industrial
- Technology

Each practice group is a global network of IIC search professionals with extensive ex-

perience, gained both by working in that specific sector and in serving its executive talent requirements.

### Global Reach

IIC is structured to deploy local knowledge and industry expertise simultaneously at several locations around the world. Today, there is one global economy, and whether your company operates globally, nationally or locally, it must be equipped to compete against the best in the world.

Whether your executive search is local or international, IIC is structured to find the world-class talent you need to succeed in the global economy.



**Harvey Hohauser**  
CEO & Founder



**Todd Hohauser**  
President & COO



**William V Weatherston**  
Vice President



**Ruthann Liarge**  
Vice President

# IIC Partners Global Reach

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