

Sourcing in China: The Swedish Experience

Tony Fang*

David Olsson

Josefin Sporrang

Stockholm University School of Business

Sweden

Tel: +46 8 16 30 63

Fax: +46 8 674 74 40

Email: tony.fang@fek.su.se

* Tony Fang, PhD, is an Assistant Professor of International Business in the Stockholm University School of Business. David Olsson and Josefin Sporrang are M.Sc graduates from the Stockholm University School of Business.

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Keywords China, cost, R&D, sourcing, Swedish firms

Abstract One of the most fascinating characteristics of today's global business landscape is that more and more western firms are undertaking sourcing activities particularly in China, a country now widely known as "the workshop of the world" The purpose of this paper is to arrive at a better understanding of how to undertake sourcing in China from western firms' point of view. Five Swedish firms, i.e., Ericsson, H&M, Åhléns, Coop, and ICA have been investigated to achieve the purpose of this study. Managerial implications are provided for conducting sourcing effectively in China.

Sourcing in China: The Swedish Experience

“The Workshop of the World”

China has emerged as one of the most dynamic elements in the global economy (Lardy 2002; Nolan 2001; Panitchpakdi and Clifford 2002). During the 1990s, US\$300 billion foreign direct investment (FDI) went to China. In 2002, China overtook the United States as the world’s largest FDI recipient (China Daily, 2003; Kynge, 2003). FDIs in China increased by US\$53.5 billion in 2003 and a total of 465,277 foreign-funded enterprises including more than 400 of the Fortune 500 are now operating on the Chinese soil. China’s recent accession to the WTO and forthcoming hosting of the 2008 Beijing Summer Olympics and the 2010 Shanghai World Expo have further lifted the country to the very frontier of global business.

One of the most fascinating characteristics of today’s global business landscape is that more and more western firms are pursuing a global sourcing strategy, undertaking sourcing activities particularly in China, a country now widely known as “the workshop of the world” (Roberts and Kynge, 2003; Chandler, 2003). Even some of the manufacturing lines earlier located in Southeast Asian countries such as Malaysia and Singapore are also moving to China (Sigurdson, 2004). China’s “insatiable appetite” for seemingly unlimited industrial manufacturing is believed to be one of the key factors behind today’s sharp rise in oil (Engqvist, 2004) and other raw materials and transportation prices (Lindahl, 2003) in world market.

Sourcing is a young academic inquiry rooted in business-to-business (B2B) literature and the specialised sourcing and purchasing literature (e.g., Axelsson and Wynstra, 2002; Day, 2002; Ford, 2002; Gadde and Håkansson, 1993; Lonsdale, 2002; van

Weele, 2002). In recent years, there has been a growing interest in global sourcing (e.g., Kotabe, 1992, 1993, 1998; Kotabe and Murray, 2004; Monczka et al., 1998; Trent and Monczka, 2002). However, the existing literature has been largely based on studies of western markets whereas inadequate attention has been given to emerging markets (e.g., Laseter, 1998). For example, except for some consulting texts (e.g., Hemerling et al., 2002; Matteo, 2003; Nordstrom, 2000), little attention has been directed to studying the phenomenon of sourcing in China, despite the fact that the country has become the world's single largest national sourcing base.

About This Study

This paper intends to contribute to the existing literature by studying western firms sourcing activities in China. The purpose of this paper is to arrive at a better understanding of how to undertake sourcing in China from western firms' point of view. We attempt to answer these under-researched questions: Why do western firms conduct sourcing in China? What should be considered when undertaking sourcing in China? What are the major factors influencing sourcing price in China? These questions reflect both strategic and operational aspects of conducting sourcing in China.

We chose to conduct case studies of Swedish firms' experience about sourcing in China. Sweden is a small country with a strong industry. Sweden has more large companies per head of population than any other country in the world (Birkinshaw, 2002). The paper is empirically based on our in-depth interviews conducted in Sweden and China during 2003-2004 with chief sourcing officers in five Swedish firms: Ericsson (telecommunications and mobile telephony), H&M (Apparel, textile and fashion), Åhléns (textile, household appliances), Coop (household articles, food), and ICA (food). The paper intends to contribute to theory and practice based on insights from this multiple case study design (Easton 1998; Yin 1994) covering a number of industries.

In this paper, the term “sourcing” is used to embrace a broad meaning of “buying”, “purchasing”, “outsourcing”, “manufacturing”, “production”, and “supply procurement” involving both in-housed (including joint ventures) and independent suppliers (e.g., offshore outsourcing). Departing from Kotabe and Murray (2004), we adopt a working definition of “sourcing” as the management of flow of components, finished products, know-how, and human resources across nations and regions in serving foreign and domestic markets.

Existing Literature

Sourcing is grounded in the B2B literature not least the so-called IMP-tradition (e.g. Axelsson and Håkansson, 1984; Ford, 2002; Gadde and Håkansson, 1993; Håkansson, 1982; Håkansson and Snehota, 1995). The IMP (industrial/international marketing and purchasing) Group has also taken a strong interest in purchasing management at both strategic and operational levels. The IMP scholars were among the first to envision that any conceptualizations of marketing, markets and business relationships and networks would be incomplete if purchasing was not included as a critical component (e.g., Håkansson, 1982). Purchasing constitutes an important source of competitive advantage and an issue which must be dealt with at the top management level (Axelsson and Håkansson, 1984; Gadde and Håkansson, 1994). Purchasing has a major contribution to cost-reduction and profit enhancement given that the value of a company’s purchases often accounts for 60-80% of its cost-of-goods sold (Ford 2002).

Although sourcing has been driven primarily by cost concerns in many firms, technology and quality considerations should be viewed as significant as cost concerns (Alguire et al., 1994). Sourcing permeates in the interfaces between R&D, manufacturing, and marketing (Kotabe, 1998; Kotabe and Murray, 2004). Sourcing

entails risks, e.g., losing core activities, loss of intellectual property, loss of corporate reputation, overdependence on suppliers, and the lack of transparency over supply process (Lonsdale, 2002). “The human factor” such as culture, perception of trust, language and communication, human resources and personal relationships is viewed arguably as the most important factor in securing successful global sourcing and supply chain management (Handfield and Nichols, 2004).

Sourcing in China offers foreign companies opportunities to acquire high-quality and low-priced product (Matteo, 2003). China can be expected to retain its labour cost advantage for a long time given its enormous pool of increasingly mobile workers, both skilled and semiskilled (Hemerling et al., 2002). Setting up an international procurement office (IPO) in China to source PRC-made components for their firm’s global operations can be a profitable option (Nordstrom, 2000). However, transaction costs such as the impacts of culture, language, communication, and administration barriers are believed to be as significant as production costs, which should be taken into consideration when conducting sourcing in China (Liu, 2002; Qu and Brocklehurst, 2003). A review of literature shows that there has been a lack of research grounded in empirical settings especially in emerging markets. In the next section, we present five Swedish firms’ sourcing activities in China to contribute to the understanding of the subject.

Five Swedish Cases

Hennes & Mauritz

H&M (Hennes & Mauritz) is a Swedish apparel retailer with a turnover about Euro 5.5 billion and 26,000 employees. H&M offers a wide range of product lines with its own brand, including clothes, underwear, sportswear, accessories and cosmetics. H&M aims at providing “fashion for everyone, from updated classics and basics to clothes that reflect the very latest international trends – always at the best price”. The H&M share is traded on the Stockholm Stock Exchange and H&M’s market value is

currently Euro 15 billion. H&M's all productions are sourced from external manufacturers and managed through 21 production/purchasing offices, located mainly in Asia and Europe. H&M opened its own local purchasing office in Shanghai in 1994 after 15 years sourcing through agencies, since the company regarded local presence as important in developing sustainable and close relationships with its more than 100 local Chinese suppliers. About 50 percent of H&M's suppliers are privately owned and the rest is owned by the state. Today there is also an office in Beijing. Of a total number of 150 employees in China, about 90 percent are local Chinese nationals. H&M emphasizes Chinese export restrictions on textile products as a main challenge when sourcing in China. The Chinese government controls the quota acquiring process in which state-owned enterprises (SOE's) are usually favored. Privately owned Chinese companies seem to have a hard time to compete on fair rules, which complicates the sourcing process. The quota acquiring process still remains a mystery even to the personnel at H&M. However, both the EU and USA have indicated that the textile quotas imposed on countries within the WTO will be removed in 2004. This would result in a sharp increase in the textile import from China, which will be favourable for H&M. Toward the end of each year prices are usually higher because of the lack of supply due to the quotas. To keep the prices at a relatively constant level a couple of new suppliers are added to the supplier base each year, giving H&M a proper gross margin of around 55 percent. Due to the lack of incentives among the employees in the SOEs, time cycles used to be much longer in every part of the sourcing process. Consequently, H&M preferred to produce clothes in China that have a fairly lasting fashion in the rest of the world, for instance baby clothing (blue and pink). If fashion changes occur, the risk is high that the Chinese will not manage to efficiently correct the changes in time. That is why most fashion products are sourced in Turkey instead. The lead times, however, have been reduced by 10 percent each year, except from the production itself. This is something that H&M has focused on and today the company has a 24-hour response time rule, which gives the suppliers a day and night to design an offer and send it to H&M. A lost deal to some suppliers has made them realize that in the fashion industry, time is a scarce resource. The Chinese

prefer to do repeated transactions rather than one-off deals. It can often be a cumbersome process to negotiate for the first time and counterparts can be suspicious. In face-to-face communication the social event of dining is an essential part. To take important decisions without eating together with your Chinese suppliers counterparts is almost impossible.

Ericsson

Ericsson is one of the largest suppliers of mobile systems in the world and 40 percent of all mobile calls are made through Ericsson's mobile telephony systems. In 2003, the turnover was Euro 16 billion and the company had around 50,000 employees in more than 140 countries. Ericsson shares are traded on NASDAQ [ERICY] and the market value is Euro 28 billion. At the corporate strategy level, China emerges as Ericsson's global supply hub for production and R&D. In April, 2003, Ericsson set up its IPO in Beijing as part of the newly established (middle of 2002) Ericsson R&D Institute in China, focusing on R&D-oriented sourcing, such as sourcing of talented engineers and technical competence. Low cost manufacturing, low cost engineering, R&D, necessity to work with local and international suppliers in China and closeness to the market (China and USA are Ericsson's two largest national markets) to understand customers needs and wants are motivations. Much of Ericsson's hardware is developed in Sweden, USA and China some of which are then manufactured in Ericsson's joint ventures in China. Ericsson emphasizes that wherever there is a product development activity there is an input from sourcing engineers and managers; sourcing must be integrated with product development already at "Day 0", implying that sourcing needs to be planned and be in place before the project gets started. The selection of suppliers in China is made in the same way as in other countries. The criteria are: quality, operational systems, turnover, product knowledge and cost. In China, negotiations continue after the deals have been made, there are constantly new negotiations; the deals are never closed. Ericsson works with many suppliers in China, both international suppliers who followed Ericsson to China and local Chinese suppliers. The suppliers are organized in a multi-tiered structure in which Ericsson has

a commercial relationship with all the first-tiered ones. Depending on the specifics of each project, Ericsson may enter into a commercial relationship with a second-tiered supplier. One success factor, when it comes to reaching a good price when sourcing in China, is competition. If competition is held continuously the costs can be held at lower levels. As long as suppliers have profit they are willing to lower their prices. If the suppliers have similar production costs, then the purchasing price will generally be the prevailing market price, which has a very small marginal. The supplier quality can vary a lot. It is necessary to have a good quality system in order to get an even quality. The Chinese are well aware that there have been and still are some problems regarding quality, but this is something that is changing rapidly. The pace with which the Chinese are learning and improving is so fast that China is believed to be able to deliver any top quality R&D components comparable to any world standards in a not distant future.

Åhléns

Åhléns is a Swedish retailer that offers products in four business areas: beauty, home, media and fashion. In 2003, the turnover was Euro 500 Million and the company had 2,900 employees. The Chinese purchase offices, with 45 employees, are located in Hong Kong and Shanghai. Åhléns has sourced products from China since the 1960s. Today most of the clothes and home articles are purchased from China. The Hong Kong office also has a payment and forwarding department responsible for India, East- and Southeast Asia, and Shanghai. The company has 85 suppliers in northern China and about 300 in the whole country of which none exceeds 10 percent of Åhléns total production in China. Åhléns has a closer relationship with about 25-30 suppliers. Most of Åhléns' suppliers are private manufacturers from simple conditions who are more pioneers than educated in business. The suppliers are primarily small and medium-size enterprises (SMEs) with 50 to 300 employees which are managed by one entrepreneur. They are generally honest, straightforward and ordinary people. They are sensible businessmen who are good at producing and accounting. The suppliers are openhearted and there is seldom any problem to get access to the

factories to inspect the production. Situations where access could be a problem are when the selling function is outsourced and the seller is afraid that Åhléns will cut out the seller. The purchases are planned up to six months in advance since the manufacturers are often adding some extra time in the agreement to make sure that there will be no problems to finish according to schedule. To stress the suppliers can make them uncomfortable, so it is better to have patience and let the process run its course. The price setting in Åhléns is based on a target cost calculation. A final sales price is set and then costs (transportation, administration and purchasing) are calculated together with a profit for each product group. The target price of the purchaser is usually close to the price offered by the supplier. In general, both buyer and seller have good information, the buyer about the competitive market prices and the seller of the costs included. Since both sides are well informed, the negotiation space is fairly limited.

ICA

ICA merged with Ahold in 2000 and the new established ICA Ahold is owned by the Dutch company Royal Ahold N.V. (50%). Royal Ahold is a food chain with 420 000 employees which conducts operations in the U.S., Latin America, Asia and Europe. The purchasing department of ICA has seven people in total and is divided in two parts: Four people work with purchasing in Europe and three persons work with overseas purchasing, where 30% of the company's purchases are done. ICA is continuously looking for areas where products can be bought for an even cheaper price. China has been a business partner of ICA since the early 1960s and the amount of goods purchased from China is increasing every year. Goods that ICA has typically imported from China are canned mushrooms and asparagus. In recent years the company has also started importing other goods such as frozen fish, egg noodles and Soya sauce. When ICA started to import from China, export organizations owned by the government were in charge of all business relations with foreign companies. All business deals were set at the Kanton Fair twice a year. *"The focus was not as much on price discussions as on the quantity you could manage to buy. There were almost*

fight over the quantities". (Interview notes, ICA.) When purchases were done at the Kanton Fair, ICA wasn't able to control where the goods came from, less have any insight into the production. Today, on the other hand, they can visit factories directly, which means the level of insight and control of the production has increased substantially. Since ICA buys large quantities – however, not as large quantities as the big buyers, Germany and the U.S. - they want to spread the risk by not relying on a single producer. Therefore, ICA is normally in contact with several suppliers within the same product segment. When the two most interesting suppliers have been identified, ICA continues to negotiate with them. Back in Sweden the purchaser calculates on volume and price and prepares for the final negotiation. Since the level of English is still poor in some parts of China, the negotiation is usually held with an exporter, who is engaged by the factory. However, dealing with the factory directly is getting more common, as the Chinese knowledge in English is improving. The negotiation normally takes about two to three weeks in total. One of the challenges of dealing with Chinese suppliers, according to ICA, is the Chinese lack of knowledge of the markets of the purchasers. Exporters from other countries travel to Sweden regularly to up-date themselves about the structure of the market. The Chinese, on the other hand, don't have the same possibility to do that. Consequently, purchasers need to be very specific when ordering products, especially products that don't exist in China, because of different traditions. What a purchaser needs to understand is that you still need to inform Chinese suppliers how the structure of your own market looks like. One year one of ICA's purchasers ordered Christmas decoration – a sort of a Christmas star - from a supplier in China. However, he didn't give any exact description of how this typical Swedish Christmas decoration was supposed to look like. Later on that year ICA ended up receiving a huge amount of boxes containing stars that were not constructed the right way and thus couldn't be sold...Some of the goods that ICA imports from China, such as asparagus, can't be purchased anywhere else in the world, so buying products from China with high quality is crucial to this company. The growing trend of private brands in the retail industry also makes high quality more important than ever. This, in combination with the fact that China is

already a low-price market, makes quality a major issue to ICA when selecting suppliers. The food industry in general has high demands on quality. A high level of control from the production stage until the goods are on the store shelves is extremely important. According to ICA, retailers all over the world try to make the Chinese understand that they must implement quality standards in their production. Thirty years ago ICA's purchasers went to China to inspect the production. Today Chinese suppliers are gradually implementing American and European quality standards. For instance, BRC (British Retail Consortium), which is about to be replaced by HACCP (Hazard Analysis Critical Control Point System), is commonly used by the retail industry. These quality standards guarantee high quality throughout the production. They provide buyers with information such as who the supplier of raw material is; who the producer is; and make sure that goods are controlled before being exported. The standards are normally good for a year and then they are up for renewal. Now when they can pay for this service to be done, purchasers from ICA don't need to go to China solely to inspect the production and delivery of products. In addition to this ICA does its own quality controls in the factories on a regular basis. They check on aspects such as hygiene, working conditions, training of staff and that documentation is done on a regular basis.

Coop

Coop is a leading retail group in the Nordic region with more than 28 000 employees in Sweden, Norway and Denmark and 2 000 stores. The yearly turnover is more than Euro 8,7 billion. Few Swedish companies were there when Coop first started doing business with China in the early 1970s, since the country was difficult to enter at that time. Nowadays, Coop sources a vast amount of goods, such as clothes, shoes, bags, porcelain and groceries from China. Coop's sourcing department, situated in the head quarters in Stockholm, is responsible for purchases for the whole Nordic area. In addition, there are offices in Hongkong (30 people) and Shanghai (9 persons), with mainly Chinese staff, that support the European co-operation. The Kanton Fair is still one of the most important meeting places for Chinese suppliers and purchasers from

all over the world. Coop’s purchasers visit the big trade twice a year, in April and in October. At the fairs the purchasers get a grasp of the market, what products the suppliers can offer and what the trends are at the moment. After a contact has been established, the purchasers visit the factories of the suppliers that they are interested in purchasing from. The rest of the process is very similar to what you do in Europe or elsewhere in the world: You know what you want to buy and you are well prepared for the negotiation. The Hong Kong office supports the purchasers in the process of selecting suppliers. For instance, they make sure that the suppliers they decide to work with follow, what is called, ‘Code of Conduct’. It is a document that specifies a number of conditions regarding health, safety and other regulations and it is signed along with the purchase contract. In order to control that working conditions are fair and that there aren’t any children among the employees Coop only co-operates with suppliers that fulfill these conditions. As in all business situations with foreign countries, there is always a matter of adjusting to the other culture. This is stressed in particular by Coop, a company that has been doing business in China for more than 30 years. Coop stresses that a long-lasting relationship with mutual trust and commitment between the buyer and the seller are critical aspects when dealing with Chinese suppliers. This is more important than a short-lived co-operation, where the buyer is willing to pay a lot. This makes it more difficult for companies entering China for the first time without any prior contact with Chinese suppliers. The fact that Coop is known in China gives the company an advantage compared to competitors. Table 1 summarizes some major features of the five cases.

TABLE ONE ABOUT HERE

Discussions

Why sourcing in China?

Firstly, cost concern is probably the most important driving force. Wages are much lower compared to European countries and this lowers the production cost substantially. The minimum wage for a sewer in China is around 800 SEK/month. There is an excess supply of low-cost workforces who are ready to work in factories. Although the wages are increasing in the east urban areas, the country is so huge that new factories are easily open in less developed provinces in the west.

China has been a low-price market for foreign companies for a long time, and still is, due to a large amount of factories, which means the price levels don't change as fast as in other markets (Interview note, Coop).

Secondly, stability of supply channels and reliability of delivery is also considered to be a reason. There are markets which are even less costly than China. However, in China, as ICA sourcing managers noted, supply networks are seldom interrupted by strikes which could be a problem in many other emerging markets. Thirdly, China is becoming an important market for sourcing advanced products and know-how. Large firms are increasingly pursuing R&D and innovation oriented sourcing in China as exemplified in the Ericsson case. China has become Ericsson's global supply hub for production and R&D. Ericsson's sourcing organization is institutionalized as part of the Ericsson R&D Institute. As R&D activities move to China so follows the sourcing. In the words of Ericsson sourcing director based in Beijing:

Here we do 3-G, beyond 3-G ... we develop a variety of products and brands... One part of our R&D organization is sourcing. R&D and product development processes cannot be developed effectively unless sourcing is an integral part of it. ... We see sourcing as part of R&D (Interview note, Ericsson).

Finally, firms conduct sourcing in China also because their customers and suppliers are operating in China. Ericsson, for example, has “forced” many of their international suppliers to move to China who in turn develop their sourcing networks in China with the help of Ericsson China organizations. More and more firms move to China not only to exploit the labour advantage but to gain strategic access to the global supplier network that is taking shape in China (Sigurdson, 2004). China is becoming a global hub of sourcing, industrial networking, and idea generation. All in all, the cases suggest that while the cost concern drives firms to conduct sourcing (Alguire et al., 1994) in China, many, especially large firms, have started conducting advanced sourcing for the purposes of R&D, innovation, and product development of strategic importance through tapping potential talents and expertise in China.

Local sourcing office

In line with Nordstrom (2000), most interviewees pointed to the benefits of setting up a local sourcing office (e.g., IPO) in China. By setting up offices locally in China and by hiring Chinese employees, cultural barriers can be handled more effectively. Chinese employees are also more familiar with the market in general and can thus support purchasers in various ways, e.g. in establishing contacts with new suppliers, in negotiating, in following the production, making sure that products meet quality standards and oversee transportation and shipping. A local IPO can also make payment easier, which can be cumbersome if it is done from outside of China. Using a local bank also enables the purchasers to pay at a later date than otherwise would be possible, so they can hold payments if there would be any specific problem with the delivery. In sum, local offices make the purchasing process more effective. Although a local office provides many advantages it still needs to be financially sound depending on the scale of sourcing and firm size. An option, if the cost of setting up a local office is too high, is to use local agents, and this has been practiced by ICA.

Technology

The technological level in most local Chinese suppliers is still not comparable with that of western suppliers. They are 1-2 years behind in high-tech industries. For companies involved in sourcing advanced products, such as Ericsson, there are a limited number of suppliers that are able to produce the products in question. In the telecommunications industry there is a high dependency on having extremely good producers. *“We try to buy more complete products. The amount of suppliers in China that can supply finalised products is lower compared to Europe and USA”* (Interview note, Ericsson). However, Ericsson also emphasized the fast learning capacity of the Chinese suppliers in technology innovation. It is possible that the evolving technology in the coastal areas will eventually lead to a split of China into two different sourcing regions, where sourcing of high technology productions will mostly be concentrated on large cities and the coast regions such as Beijing, Shanghai and Guangdong while less complex products (now also produced mainly in cities in coastal regions such as Guangdong) will be more and more produced in inland regions of China. This does not suggest that talented workforce exist only in coastal regions. As a matter of fact, many of Ericsson’s suppliers in radio engineering come from the inland Sichuan Province. This is a legacy of Mao’s times when China’s defence industry (involving telecom and radio communications) were clustered in a number of inland regions which have gradually developed high competence in their technological areas. In the future firms with advanced products can put the whole production line in China, from less complex stages to more advanced productions. Integrated sourcing involving R&D, production and marketing covering different geographical locations (Kotabe, 1992, 1993, 1998; Kotabe and Murray, 2004; Trent and Monczka, 2002) linking China with global markets is seen as a favoured strategy according to Ericsson. A shift from producing solely low complex items to producing more complex items in the future could reduce costs for companies sourcing in China. But it could also increase the risk of losing intellectual property; high technology can be at risk for being copied by competitive Chinese firms or by former employees that leave the company.

Price

As in every market, current demand and supply is an important factor of the sourcing price. In China, Germany and other countries that are large importers of Chinese products affect the price by their level of demand. The Chinese market has gone from excess demand to excess supply and this is one reason to why the prices are so low. Only 30 years ago the Swedish purchasers traveled to the Kanton Fair twice a year to ask for as much quantity as possible.

There were almost fights over the quantities” (Interview note, ICA). “The purchasers met the supplier agents at the Kanton Fair. The supplier agents sold their quota to the highest bidder and then the contract was signed (Interview note, H&M).

Nowadays, on the other hand, there is an excessive supply of low-cost workforce in China and new plants are easily opened, according to H&M. This is also confirmed by Åhléns, who speaks of overproduction in China. In contrast, advanced products are in great demand; Ericsson are trying to buy advanced products at a higher level, but the amount of suppliers that can supply at a higher level is relatively small compared to the western standard.

An aspect typical for sourcing in the Chinese market is that the quota system still has an important effect on the supply of goods in the textile industry. Suppliers must apply for an export quota and adapt their yearly production accordingly. This clearly affects the competition and as a result also the sourcing price. The sourcing price tends to increase towards the end of the year, which has to do with the Chinese export quotas. This is an important reason why purchasers should secure quotas as early in the year as possible.

It is noticeable that although China is a WTO-member, the price of the quota is still a mystery to the Swedish purchasers. They have no or little insight in how the Chinese producers obtain their quota and consequently they can't be fully aware of the cost structure of their suppliers.

Depending on if the supplier has paid anything to get the quota, their prices will vary. Either you pay the government directly or indirectly, or you get the quota for free, that is if you have connections in the government” (Interview note, H&M). The relationship different companies have with the Chinese government can also affect the cost of production (Interview note, Ericsson).

The relationship between the buyer and seller has a direct influence on cost and price. (Monczka et al., 1998). Close collaborations support the development of mutual trust and the pursuit of common goals. Could really a strong relationship win over a thick wallet? Our case studies show, mutual trust really can have an effect on the sourcing price. This is an area of consensus among the experienced purchasers/sourcing professionals:

You get a better price if you have proven to be trustworthy, than if you are unknown to the supplier and willing to pay ten times more” (Interview note, Coop). A long lasting co-operation clearly affects the price (Interview note, ICA). The fact that Coop is known in China clearly gives us an advantage [over competitors] (Interview note, Coop).

Except for Ericsson, the price setting in other case companies is based on a target cost calculation. A final sales price is set and then costs (transportation, administration and sourcing) are calculated together with a profit for each product group.

Negotiation

The effect negotiations can have on the sourcing price varies among the case studies. Several theories indicate (e.g. Fang, 1999; Pye, 1992) that negotiations are crucial to the Chinese. For instance, according to Bjerke (1999) the Chinese are always ready to discuss a deal; they are focused on sales and sales figure and they judge success in relation to direct sales. Our case studies emphasize this aspect, but with different importance and with different benefits to the purchasers.

Price negotiations used to be more common in the past, according to both Åhléns and Coop. With adequate information on both sides there is usually nothing to negotiate about. This explains why Coop has a 90 percent success rate of reaching their target price and why Åhléns' target price is usually close to the one offered. However, with new suppliers the situation is different. Then there is a larger focus on negotiations. *"Since both sides are well informed the negotiation space is fairly limited"* (Interview note, Åhléns). *"The price is always a matter of concern to a Chinese supplier. If the seller is not satisfied with a price, there won't be an order"*, says a manager at Coop, referring to the situation of dealing with a new supplier.

According to Ericsson the Chinese are very skilled negotiators and negotiating is something that goes on continuously. If there is constant competition, the cost can be held at lower levels. As long as the suppliers can make money they are willing to lower their prices. *"Whatever you are buying, competition is razor sharp and the prices very flexible, they can both go up and down so the only way to keep the right price level is to constantly make sure that competition exists"* (Interview note, Ericsson). H&M also uses multiple suppliers simultaneously per product category in order to lower the prices. Only for stretch jeans, H&M has four suppliers. *"To keep the prices at a relatively constant level a couple of new suppliers are added to the supplier base each year"* (Interview note, H&M).

Whether negotiations affect the sourcing price or not vary among industries and the history with the supplier. In industries that source complex products, negotiations are

frequently occurring. However, in commodity industries this is less common. With new suppliers, negotiations occur more frequently. Another way of keeping prices on a fairly constant level, is by using multiple suppliers, which increases competition and thus your chance of getting a good price.

Culture

According to the case companies there are few cultural differences that need to be considered when doing business on the Chinese market today. However, several of the companies shared experiences of Chinese business culture that can serve as guidance for companies that are not fully familiar with cultural aspects of doing business in eastern Asia. As the Coop manager commented, “...*there is always a matter of adjusting to the culture of the country that you do business with.*”

China is a “relationship-focused” culture (Gesteland, 2002). This means Chinese people expect to see their suppliers and partners in person much more often than what would be necessary in ‘deal-focused’ markets, such as Europe. The cases of Coop and ICA emphasized this point. These companies stressed that long-lasting relationships with mutual trust and commitment between the buyer and the seller are critical aspects when dealing with Chinese suppliers. As ICA commented: “*For a Chinese person it is important to meet face to face. We go to China twice a year, just to build relationships*” (Interview note, ICA). It takes time to build up a high degree of trust. It is also person-specific and considered necessary in the aspect of doing business in China.

While cultural adaptation is practiced by ICA and Coop, another effective way used especially by Ericsson, H&M, and Åhléns to cope with cultural differences is to let local employees do business and negotiate with local Chinese manufacturers. For example, Ericsson has 95 percent local sourcing staff in China. “*The key to success is letting Chinese people do business with Chinese* (Interview note, Ericsson). “By

hiring local staff a lot of potential cultural effects are avoided” (Interview note, H&M).

Quality

Companies that purchase from or source in China tend to be more quality sensitive than price sensitive, which has to do with China being a low-price market already. Since producing goods cheaply but with low quality can be costly in the end, the focus shifts from finding the supplier who can offer the lowest price possible to finding suppliers that can produce high quality products. Especially the ICA case brought the aspect of quality into focus. Buying products with high quality is crucial to this company. One reason is that some of the goods that ICA imports from China, can't be purchased anywhere else in the world. Another reason is the growing trend of private brands in the retail industry, which means the demands on quality from the buying companies have increased even more. Therefore, ICA uses international quality standards to secure a high level of quality of the products the company imports.

The quality of production in China has improved during the last decades but it still suffers from being synonymous with low quality. Products labeled *“Made in China”* don't have an equally good reputation as products that are made in e.g. European countries. Even though production has improved and continues to improve, it is still important for purchasers to make sure that the products being sourced keep an even and satisfying level of quality. Ericsson believes that the quality issue is temporary and emphasizes the awareness of the problem among Chinese suppliers: *“Chinese companies, in varying degrees, are thoroughly talking about quality; they are discussing quality-tools and certifications. In ten years or so one will look back and see a dramatic difference in the quality of products produced in China”* (Interview note, Ericsson). A comparison with Japan could be done in this sense. Japan had quality problems during the 1970s, which made consumers hesitate when it came to

Japanese cars, for instance. However, today nobody is questioning the quality of Japanese cars. A similar development could happen in China.

Logistics

Most of the case companies use sea freight to transport their goods back to Sweden. Coop, ICA and Åhléns prefer this, while H&M and Ericsson use air freight more often. Since transportation from China to Sweden by boat normally takes about 5 weeks, delivering goods by airplane is more common when time is a crucial factor. The vast amount of goods that is transported out of China every year has affected the number of shipping companies operating in the area. Nowadays freight ships leave China every week, which was not the case when some of the case companies first entered the Chinese market. Normally a local office will make sure that transportation is arranged and paid for and that delivery dates are kept. For some companies transportation costs amount to almost 50% of the total cost. Another area of concern is container storage method. Due to availability of low cost labor, loading and unloading of goods in some Chinese warehouse could heavily rely on workers' manual handling while professional loading method is not carefully observed. This could be very costly when the goods later arrived in terminals in western countries and have to be unloaded and processed by machines. Therefore, clear instructions about professional logistics practices need to be coordinated well with the Chinese suppliers.

Regional differences

Different production costs in different regions are noticed. The cost of local labor is increasing in the east urban areas, such as Guangdong, Shanghai and Nanjing, and therefore moving further west could mean a further reduction of the production cost and thereby the sourcing price. All the companies are well aware of this, but they also point out that going for lower prices in the west is also related to higher risks and high transaction costs (Liu, 2002; Qu and Brocklehurst, 2003) as we discussed earlier. However, the less developed inland regions offer not only low cost workforces but top engineers as well as the Ericsson case has suggested.

Change

A comparison of China 30 years ago and China of today reveal many changes. The transition from an old, bureaucratic society to a more developed and modern country is evident. *“You get surprised how quickly the Chinese market is developing. Every year we notice new products and ideas”* (Interview note, ICA). In the past, state-owned companies dominated the Chinese market. Now private companies have gradually been established due to a less controlled society, which also means competition has increased substantially.

The Chinese are more business-oriented today, especially the younger generation of exporters. They are well educated, speak English fluently and are always available on their mobile phones (Interview note, ICA).

A technically more advanced society also makes communication with suppliers much easier today. For instance, in the 1960s ICA used telegrams to communicate with their Chinese suppliers, today they can reach them directly by e-mail. The whole sourcing process, from the preparation phase until you have an order, is less time consuming than it used to be. As the case companies reported, you now receive pictures on e-mail and sales presentations on CDs. Other radical changes include modern factories and modern production methods. With a more frequent use of European designers the Chinese are also more updated on current fashion. To summarize the above discussions, we present a preliminary model of sourcing price in China.

FIGURE ONE ABOUT HERE

Conclusions

This paper has presented an exploratory case study of sourcing in China through empirical data collected at five Swedish firms in China. We have found that cost, reliability of supply, strategy, and R&D are major factors driving firms' sourcing activities in China. Large and technology-intensive firms are moving toward advanced sourcing such as sourcing of talented engineers and expertise. A number of issues need to be considered when conducting sourcing in China: (1) motivation (e.g., cost-effectiveness, motivated workforce, technology innovation); (2) importance of local presence (e.g., local offices and staff); (3) politics (government policy, WTO regulations, export quotas); (4) culture (personal relationship and trust building); (5) technology (low-end and high end variations), (6) price-setting patterns (we found that most companies use the target-costing model in pricing which is subject to a number affecting factors, see Figure 1), (7) negotiation (difficulties vary depending on complexity of products), (8) regional differences (economic development, education level, cost structure), (9) quality control (international code and standard to be used), and (10) the changing face of Chinese buying behaviour. Sourcing price is grounded in target cost calculation and influenced by a number of factors such as buyer/seller relationship, negotiation, type of product, regional differences, political and economic conditions (see Figure 1).

To source effectively in China, our cases suggest: (1) Do not assume China as one homogenous market. Different regions within China vary in terms of salaries, regional support, educational level and economic development. (2) Remember that some trade barriers exist – be familiar with them. It is important to be familiar with legal aspects, such as tariff and non-tariff trade barriers when purchasing from China. Import restrictions, e.g. quotas, can limit the supply of certain items and also cause price variations by the end of the year. Know the rules for your product. To avoid potential problems with trade barriers, don't rely on one source of supply; establish purchasing

activities in several countries. (3) Establish local offices and let the Chinese deal with the Chinese. It is good to be present locally and to hire staff locally. Chinese have a better knowledge of the market and master the language, which makes the purchasing process more effective. (4) Be prepared to invest time and effort in building strong trusting relationships. In business relations with Chinese, it is of high importance to understand the need to build and nurture relationships. Good relationships with suppliers can overcome difficulties and can be a success factor in price negotiations. (5) Make sure suppliers meet your quality standards as far as production and working-conditions are concerned. Use “Code of Conduct” and apply international quality standards to China. The quality of items that are produced in China can be shifting. Likewise working-conditions in Chinese factories can vary. Don’t take either for granted. Make sure both meet company standards. (6) Instruct your suppliers of the structure of your market as clearly and comprehensively as possible as most Chinese suppliers still have limited knowledge about foreign markets and cultures. Purchasers must be very clear in their instructions, since mistakes caused by misunderstandings otherwise can happen.

Sourcing in China is a subject which calls for more conceptual and empirical research in the future. Issues such as sourcing by SMEs (Agndal and Axelsson, 2004; Quayle, 2002), R&D sourcing (Linder et al., 2003; Von Zedtwiz et al., 2004), sourcing in the interfaces between R&D, manufacturing, and marketing (Kotabe, 1992) in China linking to a global business context need to be explored in order to gain a fuller understanding of the subject.

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	H&M	Ericsson	Åhléns	ICA	Coop
Industry	Apparel /fashion	Telecom	Household Appliances	Food	Household articles, food
Nature of activity	Sourcing	R&D Sourcing	Sourcing	Sourcing	Sourcing
Product Complexity	Medium	High	Medium	Low	Low
Product Customization	Yes	Yes	Yes	No	No
Local offices	Yes	Yes	Yes	No	No
Chinese staff	Yes 90 %	Yes 95 %	Yes 90%	N/A	N/A
Number of suppliers	100	N/A	300	N/A	N/A
Importance of negotiations	High	High	Low	Low	Low
Price setting	Target Costing	---	Target Costing	Target Costing	Target Costing
Motivation	Cost	Cost and innovation	Cost	Cost	Cost
Culture	Important	Important	Moderate	Moderate	Important
Logistics	Sea	Air	Sea	Sea	Sea

Table 1 Summary of the cases

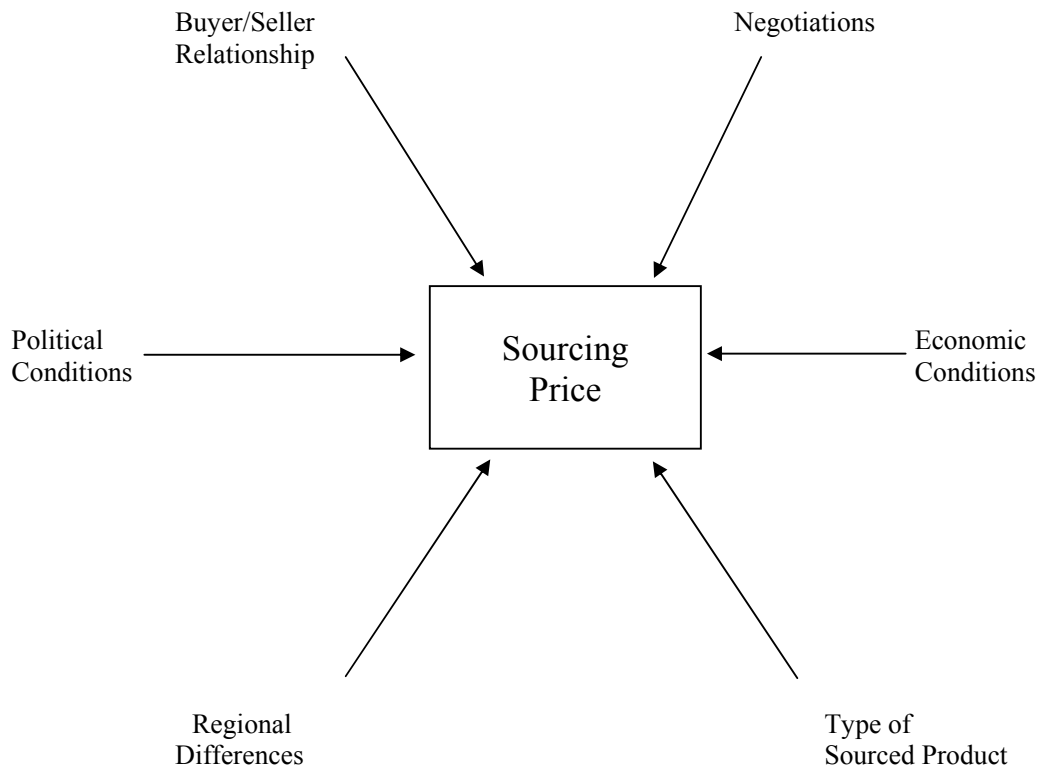


Figure 1 Factors affecting sourcing price in China