In the Middle

On Sourcing from China and the Role of the Intermediary

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Acknowledgements

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only a new corner in a continuous adventure

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Abstract

In the past three decades China’s rapid transition from a closed economy to become the factory of the world has astonished economists all over the world. Surveys among sourcing practitioners show that China is the most interesting market for sourcing and research points to lower costs as the main reason.

This dissertation is an exploratory study of the role of the intermediary for Swedish small and medium sized enterprises (SMEs) that source from China. Three questions are discussed. The first question concerns why Swedish SMEs choose to source from China. Although costs are a major factor for the companies, it is usually other triggers that cause the change in strategy, such as management interest or pressure from a large customer. The second research question concerns how Swedish SMEs choose to source from China and how the role of the intermediary is related to this process. The study shows that finding a good supplier is not difficult. The companies use informal channels, references and sometimes unorthodox methods such as following the supplier of the raw material to find suppliers that deliver high quality goods. The problem is however to maintain a steady quality and on time delivery which is why intermediaries are introduced late in the relationship. The cases in this study show example of five different intermediated strategies; Direct, Service, Traditional, RepO and FICE/WFOE. The traditional intermediated strategy is the only strategy where there is little or no relation between buyer and supplier, whereas the other four strategies involve different degrees of interaction between all three actors in the dyad; the buyer, the supplier and the intermediary.

The third research question concerned the role of the intermediary. The study shows that the respondents are influenced by their structural view on what role the different forms of intermediaries may take. Although the respondents discuss the importance of having a long-term view on the relationship with the supplier they continuously allow intermediaries to enter the relationship on a short-term basis for quality control. These quality control centers (QC) commonly work on a fixed commission based on services that has to be specified. When the buyers are trying to change their strategy to look for an intermediary with higher involvement they usually turn to internal intermediaries (i.e. subsidiaries). When deciding on a long term intermediary the buyer usually looks for competences that supplement their own knowledge – that is Chinese language, good knowledge of the Chinese market but also technological competence. What the western owned intermediaries in China stresses however is the need to find intermediaries to supplement the suppliers’ competences, so that they are able to translate the needs of the buyer’s
customer and becomes a physical reminder that they are sent from the buyer. The case of QC, shows that if a company let the relationship with the intermediary develop through interaction they can become just as involved.

The study is based on interviews with key informants at Swedish SMEs and at different types of intermediaries in China. The empirical data are presented in five themes developed through an iterative process of theoretical studies and data collection. The first two themes are directly related to the first two research questions. The third theme focuses on the sourcing process and activities of four small Swedish design companies. The fourth theme displays how the intermediaries in China discuss their role. Finally, the fifth theme pictures the supply chain of one focal company at five points in time when they are in the process of changing their supply chain to increase transparency.
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I The Chinese market, International sourcing and the Intermediary

This dissertation is an exploratory study of small and medium sized Swedish companies (SMEs) sourcing from China, the challenges that they encounter and how they rise to these challenges with the help of intermediaries. The main focus is on the role of the intermediary from the perspective of the Swedish buyer as well as from the perspective of the intermediaries in China. As more and more Swedish SMEs engage in sourcing from low cost countries (LCC) the interest for China as a sourcing market has increased. Research within international sourcing often points to the intermediate sourcing mode as an appropriate sourcing mode for small and medium sized companies. This dissertation will focus how and why Swedish SMEs use intermediaries when sourcing from China.

The first part of the title – In the middle - holds a special meaning. It refers to the intermediaries as a position in between the buyer and the seller. It also refers to the status of the business relationships, that seem to be in the middle of a continuous evolution and it refers to the transition of the Chinese economy, on its way to become one of (if not The) largest economy in the world. Finally – and most importantly – In the Middle refers to the Middle Kingdom, the direct translation of the two characters (中国) that is the abbreviated name for the People's Republic of China most commonly used in everyday speech, the country which continues to fascinate and attract me as well as sourcing managers from all over the world.

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1 SME and small and medium sized company refers to a firm with less than 250 employees, irrespective of turnover and value of assets. This is a very general definition since it does not take into account the fact that some of the firms in the study should be considered micro-firms (European Commission 1996. Commission recommendation of 3 April 1996 concerning the definition of small and medium-sized companies. Official Journal, L107, p. 4-9).  

2 Mode is used in this thesis to denote a type of strategy in accordance with literature on internationalization (c.f. Gençtürk, 2003; Johanson and Vahlne, 2009; Kotabe, 2003; Quintens, Pauwels & Matthysse, 2006).
1.1 International sourcing and sourcing from China

Increase in global business transactions (Bowersox and Calantone, 1998; Kusaba, Moser and Medeiros Rodrigues, 2011; Lockström, 2007) and the raised awareness of the importance of sourcing for firm performance (Van Weele, 2010) has sparked a new interest for international sourcing as a field of study, though much remain to be understood (Agndal, 2004; Knight, 2000; Nassimbeni and Sartor, 2006b; Quintens, Pauwels and Matthyssens, 2006; Servais, Zuchella and Palamara, 2006). In a review of research on international sourcing published in some of the top tier journals, Quintens et al (2006) divide the articles into three topic areas: the antecedents of internationalization, consequences of global purchasing and the process models of global purchasing. Within each of these areas progress has been made. Researchers have found that the main motive for upstream internationalization is costs (Beaumont and Sohal, 2004; Bellman and Källström, 2005; Cánez, Platts and Probert, 2000; Dabhilkar, Bengtsson, von Haartman and Åhlström, 2009; Kinkel and Maloca, 2009; Kusaba et al., 2011; Lockström, 2007; Monczka and Giunipero, 1984; Power, Bonifazi and Desouza, 2004; Quintens et al., 2006; Swamidass and Kotabe, 1993). Researchers have also found that for most companies upstream internationalization will improve performance on firm level as well as product level (Liu, Li and Zhang, 2010; Scully and Fawcett, 1994) and that upstream internationalization just as downstream internationalization may be explained by process models as well as typologies (Monczka and Trent, 1991; Nassimbeni and Sartor, 2006b; Swamidass and Kotabe, 1993).

With few exceptions (Liu et al., 2010) these articles focus on western companies that are sourcing from other developed countries in Europe and north America. The high focus on costs and the increased availability to international markets through the Internet, might suggest an increased interest for low cost country sourcing among practitioners as well as researchers.

1.1.1 Low cost country sourcing

Indeed, research on low cost country (LCC) sourcing has begun to find its way into journals (Kusaba et al., 2011; Lockström, 2007; Maltz, Carter and Malz, 2011; Pyke, 2006) but the concept in itself has yet to find a definition that is generally accepted. In addition to “low costs” researchers add other criteria such as high geographical, cultural and economical distances from that of the buyer (Kusaba et al., 2011; Lockström, 2007). This might make the definitions illusive since what may be defined as a low cost country at a certain point in time depends on the country of the buyer and might change as prices in that
country increase (Kusaba et al., 2011). Thus, low cost country sourcing has also been readily attributed to a number of countries with low labor costs (Lockström, 2007) where the industry mainly focuses on highly standardized goods.

Researchers that have focused on LCC, have reached some interesting conclusions. First of all, researchers have confirmed that in the case of LCC it is usually the buyer that takes initiative as the main designer of the supply chain (Lockström, 2007). At the same time other research (Carter, Maltz, Yan and Maltz, 2009; Maltz et al., 2011) seems to indicate that purchasing managers are not so objective in their assessment of sourcing market. Although costs and reliability are key criteria, part of the decision seems to be attributed not to the actual costs on that particular LCC market but to the individual and/or group perceptions of a particular market (Carter et al., 2009).

The success of LCC sourcing has also been questioned by researchers (Fredriksson and Jonsson, 2009; Ruamsook, Ressel and Thomchick, 2009; Weber, Hiete, Lauer and Rentz, 2010). In line with the definition above researchers have found that the challenges regarding the cultural, economical and physical distances to LCC markets are important (Kamann and van Niulande, 2010; Kusaba et al., 2011; Ruamsook et al., 2009; Weber et al., 2010) which calls for special competences and commitment from upper management (Kusaba et al., 2011). The study by Weber et al. (2010) shows, based on ABC calculations, that LCC sourcing had an impact on the value chain activities and above all that a considerable part of the costs of LCC sourcing comes from problems concerning language barriers, cultural misunderstandings and unsatisfactory quality in the initial stages of the sourcing project.

### 1.1.2 Sourcing from China

Among all low cost countries in the world, China has maintained its position as the most interesting country for sourcing among purchasing managers for many years (BCG, 2005; Hähnel, 2006; KPMG International, 2010; PriceWaterhouseCoopers, 2008) which will be further discussed in chapter 2. Despite the increase in labour costs (Fang, Gunterberg and Larsson, 2010), China seems to be regarded a LCC country (Fredriksson and Jonsson, 2009; Kamann and van Niulande, 2010; Kusaba et al., 2011; Lockström, 2007; Maltz et al., 2011; Pyke, 2006). The interest among purchasing practitioners has not yet had as great impact on research as might be expected although that too is starting to change (cf. Arnould, 2000; Au and Enderwick, 1994; Bellman and Källström, 2005; Fang et al., 2010; Fang, Olsson and Sporrong, 2004; Nassimbeni and Sartor, 2004, 2006a, 2006b, 2007; Salmi, 2005, 2006). In line with the research on international sourcing in general the researchers have found that the main reason for companies to choose to source from China is to lower costs (cf. Arnould, 2000; Au and Enderwick, 1994; Bellman and Källström, 2005; Salmi, 2006). Costs alone do not, however, seem to be
sufficient in explaining the benefits of sourcing from China, and the additional reasons range from flexibility of production (Marion, Thevenot and Simpson, 2007; Nassimbeni and Sartor, 2006a; Takala, Hirvelä and Liu, 2007) and market access (Bellman and Källström, 2005; Eriksson, Backman, Balkow and Dahlkild, 2008; Takala et al., 2007) to pressure from the Chinese government (Eriksson, 1995; Nassimbeni and Sartor, 2006b, 2007).

Challenges and criticalities of sourcing from China have also attracted some special interest. Platts and Song (2010) managed to set up a list of no less than 36 additional costs apart from the original price that might add to the total costs of sourcing from China. For the textile industry, quotas and tariffs have had a huge impact on the final price and timing of apparel sourced from China (Fang et al., 2010; Zhang and Hathcoe, 2008). Human resource barriers (such as problems in cross cultural communication, retention and recruitment of personnel in China) have also been studied and found to be a source of grievance for many businesses (Chan and Chin, 2007; Jiang, Baker and Frazier, 2009; Pedersen, 2004; Ruamsook et al., 2009). A long-term view and good relationships are suggested in order to overcome these difficulties in Chinese business culture (Fang et al., 2004; Nassimbeni and Sartor, 2007; Salmi, 2005, 2006). Indeed, research by Fang et al. (2010) suggests that when the relationship is established the main reason to continue to source from China despite rising costs of labour instead of moving on, is the trust between the business partners both in terms of quality and in terms of corporate social responsibility.

1.1.3 Small companies sourcing from China

To sum up the discussion above, the interest for low cost country sourcing in general and China in particular is increasing both among researchers and practitioners (as suggested by the reports of KPMG, BCG, PWC etc. referred to above). Costs are a main driver while cultural and geographical distances might negatively affect the success of low cost country sourcing, which has been supported by research on sourcing from China.

There is however one point at which the researchers and practitioner reports do not seem to match. Whereas the empirical findings of the researchers above in most cases focus on large companies, the practitioners’ reports seem to indicate that not only large companies are sourcing from China, small and medium sized companies (SME) are following suit. The study by Eriksson (2008) is an exception since it is focusing on the motives of Swedish SMEs for offshoring (i.e. cross border outsourcing). Eriksson’s findings suggest as mentioned above, that these SMEs have multiple reasons for offshoring, beyond costs. The study does not focus exclusively on China however but on offshoring of Swedish SMEs in general and does not relate the findings to any specific low cost country. Considering that the challenges involved in sourcing from low cost countries in general (as suggested in the discussion above) and
considering that there are low cost countries closer to Sweden geographically why do Swedish SMEs source from China?

1.2 Intermediaries in Sourcing

Just as LCC sourcing has caught the interest of researchers, research on intermediaries in general has increased in the past few decades. It is now generally acknowledged that intermediaries have had an important role in facilitating international trade (Ahn, Khandelwal and Wei, 2011; Akerman, 2011; Balabanis, 2000; Feenstra and Hanson, 2004), and estimates made using Chinese statistical data suggest that about 22 per cent of exports are handled by Chinese Intermediaries (Ahn et al., 2011). Most research on intermediaries however focuses on downstream intermediaries where the seller is the designer of the supply chain (Ahn et al., 2011; Akerman, 2011; Balabanis, 2000; Biglaiser, 1993; Felbermayr and Jung, 2011; Peng and Ilinitch, 1998; Peng and York, 2001). As suggested above, when it comes to LCC sourcing it is usually the buyer that designs the supply chain (Lockström, 2007) which is the perspective of this dissertation. Thus this chapter will look at the intermediary in the context of international sourcing in particular.

1.2.1 Research on Intermediaries in International Sourcing

Within international sourcing research intermediaries have had a somewhat limited role. In regards to research on antecedents and barriers to international sourcing, intermediaries are described as facilitators, in line with top management support, type of industry and long-term relationship prospects (Quintens et al., 2006).

Intermediaries are also discussed as a part of the sourcing process. There are a number of models that all carry the legacy of the export oriented process models developed at Uppsala University in the 1970’s (cf. Johanson and Vahlne, 1977, 2003, 2009; Johanson and Wiedersheim-Paul, 1975). These models include the models by Rugman (in Nassimbeni and Sartor, 2006b), the model developed by Monczka and Trent (Monczka and Trent, 1991; Monczka and Trent, 1992) and the Monczka and Giunipero model (Giunipero and Monczka, 1990) in which intermediaries are portrayed as a stage in the development of sourcing capabilities in the seemingly inevitable evolution to become a global player. In the early phases intermediaries serve the unaccustomed sourcing company with better local knowledge and access to relationships (Giunipero and Monczka, 1990; Monczka and Trent, 1991; Monczka and Trent, 1992; Nassimbeni and Sartor, 2006b).

Intermediaries are however associated with a cost for their services and with new technological advances in infrastructure and increased global experience
the intermediaries might, however efficient, seem to be doomed to be surpassed as time goes by. This has given rise to the term “traders’ dilemma” which suggests that if an intermediary performs well and increases the understanding and involvement between the supplier and buyer, their services will eventually be redundant as the buyer becomes more involved in the relationship with the supplier and the products become more important (Ellis, 2005, 2010). In addition, research suggests that the more satisfying the buyer – supplier relationship is the more efficient the supply chains become (Quintens et al., 2006), which does not seem to point to the favour of intermediaries.

To sum up, researchers in international sourcing seem to view intermediaries as a temporary strategy or mode, used in the early phases of international sourcing in order to overcome knowledge barriers and to facilitate small volume purchases. Intermediaries may also be perceived as an entry ticket to business relationships but all in all a temporary mode that will become obsolete when the relationship between supplier and buyer develops in accordance with the traders’ dilemma.

1.2.2 Research on Intermediaries in Sourcing from China

Despite lack of empirical data on SMEs, researchers suggest that due to the challenges in regards to the geographical, cultural and economic distances companies with limited resources and small volumes (such as SMEs) should use intermediaries for sourcing (Nassimbeni and Sartor, 2006b; Quintens et al., 2006). Using intermediaries would for example facilitate purchases of small volumes through bundling (Nassimbeni and Sartor, 2006b). Based on case studies of large Italian companies Nassimbeni and Sartor have developed a typology for sourcing in China (Nassimbeni and Sartor, 2004, 2006a, 2006b, 2007). As opposed to the process models for international sourcing described above, this typology describes three main types of sourcing strategies that the companies wishing to source from China may pursue. Apart from imposed sourcing and direct sourcing, these researchers suggest intermediated sourcing as one type of sourcing especially suitable for small and medium sized companies. Two types of intermediating strategies are distinguished: traditional intermediation and out-sourcing of international sourcing services (Nassimbeni and Sartor, 2006b, 2007). The first is defined as a situation where the interaction between buyer and supplier is more or less absent and thus the visibility of the supply chain is limited. The intermediaries according to this are to be perceived as wholesalers that buy products on the Chinese market and then resells them on other markets (Nassimbeni and Sartor, 2006b).

The other intermediating strategy is when a relationship between the buyer and supplier exists, but some services are outsourced in order to overcome absence of physical presence in China (Nassimbeni and Sartor, 2004, 2006b, 2007). Nassimbeni and Sartor state based on their research that in the early phase of this type of relationship it is common that the intermediary (or service
provider) represents the only link between buyer and supplier. The difference between using an agent or using a service intermediary may then according to Nassimbeni and Sartor (2006b) be rather limited, at least in an ongoing process of continuous sourcing.

Nassimbeni and Sartor argue that the intermediaries’ contribution to the buyer-supplier relationship lies in the network of relationships and local business knowledge, which is supported by Fang et al. (2004) who point to the advantages of letting Chinese employees handle the tricky parts of Chinese administration and bureaucracy such as government relationships. Some studies are however critical to the use of intermediaries, especially the use of Hong Kong intermediaries for sourcing in China. Feenstra and Hanson (2004), for example, find that Hong Kong intermediaries regularly use mark-ups for Chinese products that are re-exported and that the size of the mark-up vary depending on product and destination market. Other researchers find that the cultural differences between the Hong Kong Chinese and Mainland Chinese lead to an authoritative leadership style that might harm the relationship between buyer and seller (Trimarchi and Liesch, 2006; Trimarchi, Liesch and Tamaschke, 2009).

1.2.3 Intermediated sourcing and SMEs

Although reasonable to suggest, in line with the Nassimbeni and Sartor typology, that an intermediated sourcing strategy is suitable for SMEs due to the small volumes and limited resources, practitioners reports (again) seem to indicate that a majority of the direct investments in China by Swedish companies were made by small companies (Hähnel, 2006). What does this indicate? It might be that Swedish SMEs prefer direct investments to using intermediaries. It might also be that despite small volumes and limited resources, China as a sourcing market is today accessible to Swedish SMEs to source directly. Thus the second question that is raised through this discussion relates to how Swedish SMEs source from China.

1.3 Purpose and thesis outline

Although an increasing number of small Swedish companies is turning towards the Chinese market for sourcing (Hähnel, 2006) despite the uncertainty as to whether anticipated cost advantages are obtainable (Fredriksson and Jonsson, 2009), the discussion above shows that there is still much to learn about why and how these SMEs source from China and the use of intermediaries in doing so.

There is however other questions that have been raised above with regard to the use of intermediaries. On the one hand intermediaries are suggested as a
suitable strategy for SMEs to overcome the economic, cultural and physical distances to China (Fang et al., 2004; Mahnke, Wareham and Bjorn-Andersen, 2008; Nassimbeni and Sartor, 2006b; Peng and Ilinitch, 1998; Peng and York, 2001), while at the same time their value has been questioned by other researcher (Feenstra and Hanson, 2004; Trimarchi and Liesch, 2006; Trimarchi et al., 2009). Considering the world today, where infrastructural advances and an increased availability of English speaking representatives for Chinese suppliers, why would SMEs use intermediaries?

On the other hand, if the SMEs choose to source long-term through intermediaries (either through agents or directly with the help of service intermediaries) as suggested by the typology of Nassimbeni and Sartor (2006), what role will these intermediaries have? Given that roles evolve as relationships develop (see chapter 3.1.2) how will the Swedish SME perceive the role of intermediaries in China in the long-term relationship between the Swedish buyer and the Chinese supplier? While the Swedish SMEs are organizing their international upstream activities, the intermediaries in China, threatened by the traders’ dilemma will most likely find some strategy to avoid this fate. Thus it becomes interesting to understand how the intermediaries in China perceive their role in relation to the Swedish SME buyers. In line with this the purpose of this thesis will be defined as follows.

1.3.1 Purpose

The purpose of this thesis is to explore the role of intermediaries for Swedish SMEs sourcing from China.

1.3.2 Research questions

The discussion above and the purpose lead up to the following research questions:

1. Why do Swedish SMEs source from China?
This question is important since it is related to the motives of the SMEs for choosing China as a market for sourcing and thus for the subsequent choice of strategy. It is also important for understanding whether China is a temporary solution to lowering costs, indicating that the companies will move on to other low cost countries when/if prices become too expensive in China?

2. How do Swedish SMEs source from China?
International sourcing research pointing to the process view on internationalization suggests that intermediaries are a temporary strategy that will be abandoned once the buyers gain sufficient knowledge about China. On the other hand the typology by Nassimbeni and Sartor (2006) suggests that
intermediation per se is an appropriate strategy for small and medium sized companies.

3. How do (a) the Swedish SMEs and (b) the intermediaries in China perceive the role of the intermediaries in China?
If intermediaries are not a temporary strategy, why do the Swedish SMEs choose to source through intermediaries long-term? How do the Swedish SMEs perceive the role of the intermediary? Equally important is of course how the intermediaries themselves perceive their role by which they are able to keep their position as valuable members in the supply chain of Swedish SMEs?

1.3.3 The Path of a Journey – Thesis outline

As mentioned in the purpose this is an exploratory study, and the structure of the thesis has developed as the analysis of the material unfolded (see chapter 3). The structure of my dissertation has also taken a somewhat unorthodox path (see figure 1.1). While chapter 1 attempts to give the reader a theoretical background to the dissertation there is a practical side to this topic that is equally interesting, which is why chapter 2 gives an introduction to the Chinese market and the unique role that intermediaries have had on this market historically, legally and culturally. Chapter 3 follows with a methodological chapter that discusses the empirical data collection, study design and how the themes were developed.

In chapter 4 a tentative model, built on the iterative process of searching and reviewing previous research while analyzing the empirical material, is presented.

This tentative model is then reflected upon and revised in the themes in which the empirical data are presented. In figure 1.1 only the silhouette of the tentative model is visible, for full view of the model see figure 4.10.
Chapter 5-9 presents the empirical data in the form of five themes that are related to the research questions above. The first theme (chapter 5) looks at the motives of Swedish SMEs for sourcing from China, which corresponds to the first research question (RQ1). The second theme looks at the internationalization process of the Swedish SMEs, which subsequently corresponds to the second research question (RQ2). The empirical material for the third research question is represented in three chapters. The role of the intermediaries from the perspective of four Swedish SMEs is represented in chapter 7 while the voices of the intermediaries in China on the same subject are presented in chapter 8. In chapter 9 the role of the intermediary is looked upon in the setting of a Sino-Swedish supply chain of a particular focus company through time, to display how the perceptions of the role of the intermediary change.

Chapter 10 contains an analysis based on the tentative model presented in chapter 4 based on the empirical findings of all five themes and is followed by final reflections in chapter 11.
2 Dragon Suppliers, Viking Buyers and the Intermediaries

As mentioned in chapter 1, China is ranked high among sourcing managers as an interesting market for sourcing. What are the advantages that spark this interest? What challenges does the Chinese market present? This chapter is mainly based on consultancy reports and practitioners’ tales. It describes the advantages and challenges of sourcing from China and the pros and cons of using intermediaries. The chapter starts with an introduction to China and ends with a description of the special role that intermediaries and trading houses have had in China.

2.1 The awakened dragon

For thirty years China has been top news in business newspapers and business magazine all over the world. Since the first reforms in 1978 that opened up the Chinese economy to foreign investments, the GDP growth has reached a stunning 9 per cent annually and China has moved up from being a marginal country in terms of business to become one for the top players in global economy and one of the largest recipients of FDI in the world (Fang, 2005; Jacques, 2009; Kotler and Kartajaya, 2000; Lieberthal and Lieberthal, 2004; Ma and Li, 2004; Nassimbeni and Sartor, 2006b; Shenkar, 2006; Tao, 2010). In 2010 China finally surpassed Germany as the world’s top exporter, thus earning its reputation as the factory of the world (BBC News, 2010; Bradsher and Dempsey, 2010; Turner, 2010).

The road towards becoming a major player in world economy has been paved by small incremental changes. When Deng Xiaoping proclaimed that getting rich is glorious the vast majority of the manufacturers were state-owned enterprises (SOEs) i.e. large institutions with old fashion production facilities and government officials in management positions. Although reforms, prior to 2000, have resulted in a reduction of the number of SOEs, it still means that companies that started to source from China during the 1980s most likely bought their products from a state-owned company. The foundation of Chinese manufacturing during the early period of Chinese open policy has rested on the resources that were most readily available to the large state-owned manufacturers – low labour costs (Shenkar, 2006). Shenkar argues that the “pricing floor” that Chinese manufacturers have created based on low labour
costs, subsidies and minimum costs for development (due to a disregard of intellectual property) has left original brand manufacturers with little choice but to respond to the threat, either through producing parts of or the whole product in China or other low cost countries, increase productivity through for example automation or shift focus to technology intensive product lines that are less cost sensitive. At the beginning of 2010 it became clear that China had moved up to become the largest merchandise exporter in the world, surpassing Germany, at a value of 1202 billion US dollars which is equivalent to 9.6 per cent of world merchandise export (WTO, 2010). Looking at the statistics provided by the World Trade Organization (WTO, 2010) the unique status of China as a manufacturing nation becomes evident. According to this document, 34 per cent of all clothing is manufactured in China as compared to 4 per cent each in India and Turkey. Even though the share of world production in other manufacturing areas is rather low, ranging between 4-7 per cent in ranking, they hold top-five position in most categories outlined by WTO. Despite continuous alarms for rising labour costs and inflation (Chee and West, 2007), sourcing managers continue to place China at the top on their list of priority (BCG, 2005; Hähnel, 2006; KPMG International, 2010; PriceWaterhouseCoopers, 2008) especially when it comes to large volumes of standardized products involving little intellectual property (KPMG International, 2010).

2.1.1 The Dragon Suppliers - Sourcing in China

The flow of direct investment into China during the first two decades of open door policy concerned primarily large multinational companies. The Swedish company LM Ericsson, who sold its first telephones in China before the end of the 19th century, established their first sales office in China in 1985 (Wickman, 2011), along with other large Swedish companies such as Scania, Alfa Laval and Sandvik. The Chinese government made sure to render advantages to the companies that moved production to China, if you wanted to sell your products in China you had to contribute to the economic development (c.f. Eriksson, 1995), thus offices for sales or procurement were soon to be joined by production facilities, in-house or outsourced.

At the turn of the century, the interest among small and medium sized companies had increased. Out of the 154 Swedish companies that were identified as new entrants on the Chinese market between January 2003 and June 2006, 75 per cent were small or medium sized, 21 per cent having less than 50 employees globally (Hähnel, 2006) and this trend is supported by studies in other countries (BCG, 2005; KPMG International, 2010; PriceWaterhouseCoopers, 2008). The reason for this new trend might be that the small companies follow their customers that have already established

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3 This figure relates to new entrants only thus excluding expansions of already existing operations in China by Swedish investors.
production in China, increased competition, a search for new markets in combination with the technological improvements in infrastructure that have facilitated communication worldwide (Eriksson et al., 2008).

Together the reports from consultancy agencies such as Boston Consulting Group (BCG, 2005), PriceWaterhouseCooper (2008) and KPMG (2010) point to a couple of interesting aspects regarding sourcing from China, amongst others that there are differences between LME and SME sourcing in China. One of the differences reported by PWC PriceWaterhouseCooper (2008) is that among German companies small companies experience higher cost savings than their larger counterparts. PWC interprets this phenomenon as a result of the difference in aim between the two categories of companies. Smaller companies source from China in order to reduce costs whereas larger companies source in China in order to gain access to the market and are thus willing to accept higher prices (PriceWaterhouseCoopers, 2008). On the other hand, the study by Hähnel (2006) suggests that 45 per cent of the SMEs feels that they had been negatively affected by the adversities of trading in China, as opposed to 28 per cent of the large companies, which leads Hähnel to draw the conclusion that SMEs are in greater need for help in their sourcing activities in China. The main problems suggested by Hähnel (2006) are language and culture but other studies suggest other “hidden” costs such as problems of forecasting demand of the products in Western markets when adapting to high volume purchases, the cost of correcting quality issues and the cost of not getting the products on time (BCG, 2005) which affect the overall success of the venture.

Another difference between large and small firms concerns entry mode. The results from the surveys in these consultancy reports suggest that local presence in China is common. In the report by PriceWaterhouseCooper (2008) 46 per cent of the respondents used some locally-based in-house procurement function, 38 per cent used purchasing staff at affiliated companies and 24 per cent used agents (multiple answers were possible). Only 24 per cent reported that they used other methods including direct purchase and 4 per cent had left the question unanswered. When the data are broken down into two categories i.e. companies with an annual sale of more than €500 million and companies with an annual sale of less than €500 million, the figures become even more interesting. The companies with less than €500 million annual sales companies seem to dominate the use of locally-based in-house procurement functions and purchasing staff at affiliated companies, whereas the smaller companies seem to have a tendency to use agents or other purchasing methods. Even though the KPMG reports reflect only German companies, Swedish companies are in the lead regarding the establishment of IPOs (international purchasing offices) in China. According to a study by Accenture, 5 per cent of all IPOs in China had Swedish headquarters, only surpassed by USA, German, France and the Netherlands (Schwaag Serger and Widman, 2005).

One of the things that LMEs and SMEs seem to have in common though, is the belief that relationships are becoming more and more important in order
to overcome adversities. There seems to be a continuous trend towards fewer suppliers and deeper collaboration (KPMG International, 2010; PriceWaterhouseCoopers, 2008). Among the respondents in the KPMG report (2010) a majority expected a number of activities such as cost reduction, supply chain agility, product manufacturing, product development and innovation, to either be transferred completely to the suppliers or to involve a higher degree of collaboration in the future.

2.1.2 Viking buyers - Swedish SMEs sourcing in China

Figure 2.1 sums up the discussion above. The gap between the offer from the Chinese manufacturers (i.e. large volumes of low price standardized goods) and the demand from the Western SMEs (i.e. small volumes of non-standardized goods of high quality) seems to present a challenge to Western SMEs looking for lower prices. The key to this challenge seems to be closer collaboration with the suppliers while at the same time local representation, an agent, an IPO or using purchasing staff at affiliated companies, seems to increase.

**Figure 2.1 The Dragon vs. the Vikings.**

The PWC report above makes the assumption that because small companies are more efficient in raising the profitability the main goal of small companies are to lower costs. At the same time the sourcing market in China is structured to suit the needs of large companies that are able to order large volumes of goods that are labour intensive and with low degree of customization. Besides, if local representation is needed this may further lower the profitability of the venture. Building up an IPO demands resources and this might be one of the reasons why more small companies than large prefer to work through agents. Still, agents will also add to the costs. If lowering costs is the main purpose for small companies to source from China, under the basic assumption that an agent will add to the total cost of the product, why do small companies prefer agents to a higher degree than their larger counterparts? What is the role of the
intermediary – the agent or the IPO – when western companies source in China?

2.2 Western Businessmen in China

In the KPMG report (KPMG International, 2010) companies could choose between three different sourcing strategies (apart from other and no answer). These three were agents, purchasing staff at affiliated companies and a local in-house procurement function. Beyond the figures of how many companies that choose one or the other lays the question why, to which the KPMG report offers no explanation. The following chapter will provide some insights from western businessmen with experience of doing business in China that gives further insight to this problem.

2.2.1 The Accidental Intermediary

In the fall of 1997 I enrolled as a student at the Second Foreign Language Institute in Beijing, studying Mandarin. Located in China I took the opportunity to interview a couple of expatriates, Swedish businessmen located in Beijing. During this time, I also had a visit from a local politician from the southern part of Sweden. Jan Persson had travelled back and forth between China and Sweden since China first opened its doors to trade with the West in the late 1970s. Jan and I ended up spending a whole day together and while sightseeing Beijing, Jan Persson opened my eyes to the intricacies of Chinese business life through the many stories that he had to tell. The main lesson he had had to learn was patience. Though it might feel as if everything is standing still there is always something happening.

The trips to China were usually planned in detail but as he arrived in Beijing, Persson sometimes gave further suggestions as to whom he would like to meet. Let’s say that he would like to talk to the Governor of a specific region in southern China for some purpose. The Chinese host would acknowledge his wish and then nothing happens. Day after day goes by to the point where he would almost start to believe that they had all forgotten. Then at the end of the week, just the day before he is about to return to Sweden, then suddenly that Governor shows up. At a dinner party, conveniently sitting next to him or at an office that they just happen to stop by on their way between two other meetings. If the Governor does not show up – it is not because they have

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4 These interviews took place in Beijing at the office of the respondent. The respondents were all Swedish expatriates found through the register of the Export Trade Council. Though not audio recorded, notes were taken during the interviews and saved in a notebook.
forgotten. It is because it was impossible at that specific time to make the meeting possible and next time in Beijing it is likely that the meeting will take place.

Although the main purpose of Perssons’ travels was not of commercial nature, as the years passed companies were able to benefit from the network of contacts that evolved, sometimes in much unexpected ways. There are a couple of windmills standing along the shore of Hainan Island that come from a Swedish company; a deal that Persson had a special role in. One day as Persson was visiting these parts of China, the car in which he was travelling in together with some local politicians suddenly stopped in the middle of nowhere. Not knowing what to expect Persson stepped out of the car, only to find himself surrounded by a group of Chinese businessmen and women in suits. One of the Chinese businessmen gestured towards the view of the seaside and presented his idea about having windmills there. Persson nodded and answered in a non-committing way that windmills might be an environmentally good idea to solve the increasing demand for electricity. Then came the punch line: “we want you to sell it to us, mr Persson”.

Although Persson tried to convince the Chinese businessman that he knew nothing about windmills, the man persisted. You do have windmills in Sweden, don’t you? Of course we do. Then, you should sell some to us. He was not really interested in how much Persson knew about windmills, they trusted him to find the best supplier. Thus, as Persson got back from his journey he started to read up on windmills and contacted a few companies – and a couple of years later they were ready to supply mainland China with electricity.

The main network of Jan Persson evolved around one contact, a Chinese businesswoman who had built up a number of companies in a small village outside Beijing. Throughout the years the relationship between this Chinese businesswoman and Persson developed far beyond what we in Sweden would consider to be a strict business relationship to become more of a social friendship. As the daughter of the Chinese businesswoman got admitted to Lund University, Persson and his wife were there to help her settle in Sweden.

2.2.2 Challenges in Chinese Business Life

Since 1997 the bookstores have been flooded with more or less biographical books about the adventures of Western businessmen in China (c.f. Alley, 2003; Bjorksten and Hagglund, 2010; Chee and West, 2007; Chen, 2001; Clissold, 2010; Fang, 2005; Ganster, 2009; Henderson, 2010; Huitfeldt, Johnson and Wong, 2007; Jeal and Cann, 2009; McGregor, 2007; Midler, 2010; Pandya, 2007; Rogers, 2009; Stockelberg, 2007). These books are filled with stories similar to that of Jan Persson above, lucky chances, cunning victories but also defeats and strategies that backfired.

These books contain a myriad of stories about the difficulties of doing business in China, from showcase factories (Midler, 2010), quality defects not
anticipated (Chee and West, 2007; Midler, 2010), communication breakdowns (Alley, 2003) to difficulties in ensuring conformation to ethically, socially and environmentally responsible codes of conduct (Huitfeldt et al., 2007). At the top of this list is quality.

In 2007/2008 “the Mattel affair” received a lot of attention as the toy making company was forced to make large recalls of two different products due to quality problems just before Christmas 2007 (Barboza, 2007, 2008; Barboza and Story, 2007; Biggemann, 2008; Casey, Zamiska and Pasztor, 2007; Choi and Lin, 2009; Dee, 2007; Lipton and Barboza, 2007; Roloff and Åsländer, 2010; Sethi, Veral, Shapiro and Emelianova, 2011; Story and Barboza, 2007). Despite efforts to supply safe products and a reputation of being a very conscientious in terms of quality (Johnson, 2001), Mattel was forced to recall first 436,000 toys due to high levels of lead in the paint and then, a couple of months later, another 18.2 million toys from which the magnets were falling off (Barboza and Story, 2007; Lipton and Barboza, 2007; Story and Barboza, 2007). In the public apologies that followed, Mattel transferred the blame onto the Chinese manufacturers as well as the poor regulatory system in China (Casey et al., 2007; Lipton and Barboza, 2007).

If anything, the Mattel case seems to indicate that carefully planning the supply chains, ensuring high quality is a challenge. Midler (2010) calls his book “Poorly made in China” and the book is an odyssey of tricks and tactics from manufacturers as well as importers in a game where profits are constantly declining, all viewed from the position of an American living in China assisting his fellow countrymen to source from China. Just like Jan Persson in the story above, Midler became an intermediary not by design but through circumstances when he, as a student in China, was contacted by fellow Americans to help them in their contacts with Chinese manufacturers. With Chinese language skills as his major qualification, Midler describes the game between the Western importers and the Chinese manufacturers where one is continuously trying to outwit the other. For every price reduction there is a new way to lower the cost of production, a smaller tag or a cheaper bottle that the importer just might not notice. Is low price and good quality really compatible? The way that Midler describes his work local presence seems essential (Ganster, 2009; Midler, 2010). On the other hand, the manufacturers described by Midler do not seem to really perceive him as a representative of their customers. When he discovers the tricks of the manufacturers they simply ask him not to tell the customer and when the customer demands that Midler do unannounced visits, the manufacturer feels that they are no longer trusted. The overall message that Midler (2010) seems to convey is that language skills are more important than technical skills. Regarding his Chinese counterparts, the agents as he calls them, he finds them to be a problem to the Western importers. Although expected to look around for the lowest prices the well connected will continuously hand the orders to friends and relatives with whom good guanxi (see chapter 2.3.4) relations exist and when quality fails they will automatically side with the
manufacturer against the customer. On the other hand, if not well connected, the agent and manufacturer will start to blame each other when things go wrong and little help will reach the customer on the other side of the world. Thus, Midler (2010) argues that the services that he provides are worth the costs and will continue to be important in the long run.

2.2.3 The Myth of a New Frontier

The other books such as Jeal and Cann (2009), Bjorksten and Hagglund (2010) Clissold (2010) and Rogers (2009) represent the businessmen who did it “on their own”. Although most of these books in some way or another recommend close collaboration and/or presence in China they describe continuous visits to China that are filled with negotiations and factory visits. The main character is usually one man who tells the story of how he rose to success in a very cunning way by outsmarting Chinese businessmen, through finding the backdoor or the crack in the system. The stories depict a constant battle for lower prices and higher quality. These books breathe an air of “I did it on my own”, which in some ways create a contrast to the idea in the chapter on the accidental intermediary above where the intermediary is the main character, the door opener. In the wild East there seems to be no rules and whoever gets the cheapest deal wins. All in all there is an air of excitement which all in all creates that golden thread that seems to contribute to the myth about China as the new Klondike for business, the last frontier to conquer. In these stories intermediaries rarely have any role, and if they do they are usually met with some suspicion.

2.2.4 Pros and cons of sourcing from China

Following the stories above, there seem to be rather strong arguments both pro and con the use of intermediaries when doing business with China (see figure 1.2). On the one hand Midler (2010) shows through his examples that knowing the language, understanding the culture, showing commitment and, above all, local presence, are paramount to be able to see beyond all the tricks that are played against the Western customer by Chinese manufacturers. The arguments that the practitioners present boil down to the need to control the suppliers.

Midler on the other hand is speaking on his own behalf, as a representative of a western quality controller in China. The importers, exporters and other western businessmen in China, however, represented by the selected authors above (Bjorksten and Hagglund, 2010; Chee and West, 2007; Clissold, 2010; Ganster, 2009; Henderson, 2010; Jeal and Cann, 2009; McGregor, 2007; Stockelberg, 2007), point to the added costs that an intermediary represents in a game where the bottom line is to get the lowest price possible. The “do it yourself”-myth emphasizes that given the modern technology of e-mail and
reliable telephone lines and as more and more Chinese learn to speak English, physical distance is easily overcome. Nowadays, when it is not so hard to find English-speaking personnel with whom to communicate, there is no need for an interpreter to translate. Instead of control, trust and relationships are emphasized.

Still intermediaries exist. Finding a quality controller (QC) or consultant willing to help western companies in China is easy. Many of the companies with a long-term history of doing business in China have some sort of presence – an international purchasing office, (IPO), a sales representative or manufacturing. Going back to the stories above there seems to be one thing in particular that makes the intermediary worth the cost, i.e. quality of products sourced in China. Though from the perspective of the intermediaries their services were needed, from the perspective of the western buyer their role could be discussed. Thus, from a general interest in the booming market of People’s Republic of China, my interest for this thesis was directed towards the role of the intermediary in the context of western companies sourcing from China.

### 2.3 The Role of Intermediaries in China

The practitioners in chapter 2.2.2 displayed some suspicion against the use of intermediaries, whereas the Chinese seemed to involve not only traditional intermediaries but managed to involve visiting politicians to act as intermediaries on their part (see chapter 2.2.1). The use of intermediaries is not only a management strategy in China – from an historical perspective, a legal perspective (i.e. the laws that have been introduced in the past thirty years) and from a cultural perspective intermediaries have had a special place in Sino-foreign trade.
2.3.1 The Historical Legacy of the Trading Houses

In the history of trading companies China has a special place. At a time when China was more or less secluded from the rest of the world, the East India Companies monopolized the trade to China through a royal charter from London, which marked the beginning of the golden era of the trading companies (Peng and Ilinitch, 1998). The Swedish East India Company was one of the premier traders with China and it was in business between 1731-1813 and although tea constituted 80 per cent of imports, there was a substantial amount of porcelain, silk, drugs and spices to be auctioned as the ships arrived in Gothenburg (Söderpalm, 2000).

The monopoly was not only effective outside China. In 1759 only Guangzhou in southern China was open to foreign traders (Fairbank, 1994) and the Chinese side of this trading line was organized so that a number of merchant families were commissioned by the government to act as brokers, holding stock and setting prices to the foreign traders. The foreign traders were assigned to a specific Cohong, a guild made up of the Chinese merchants allowed to trade with foreigners, which meant that they were not able to negotiate prices by use of competitive forces or go beyond the intermediary (Fairbank, 1994). The foreign traders that decided to stay in China were confined to live on the island of Hong Kong during the trading season, although most of them preferred to reside on the Portuguese colony Macau in the low season.

The system of cohorts had many disadvantages. One was that since the superintendent of maritime customs, a Manchu official appointed directly from the Imperial Household, were constantly pressing the cohorts for “extra” money, the Chinese trading house often lacked the resources to fulfil the agreements with the East India traders, to supply them with the goods they had demanded at requested quality (Fairbank, 1994). Judging by the amount of mishaps in quality that occurred, it seems that then, as well as now, the importance to give proper instructions was vital for the outcome of the product. In his book about Chinese porcelain imported by the Swedish East India Company, Stig Roth (1965) refers to a case where the Swedish buyer used the corner of a page in a notebook to draw his coat of arms and sent it off with the traders ordering a full set of plates and cups. When the plates finally arrived he found the coat of arms perfectly painted on the front side of the plate but also some scribbles from his daughter on the back-side of the plate. As it turned out, the notebook was used as a diary by the daughter and the notes that she had scribbled was on the backside of the note that the noble man had sent off to China. Talk about meticulous! The plate is on display at a museum in Stockholm today.

The Swedish East India Company disappeared in 1813, after years of declining returns and increased risks due to the political climate in the world (Lindqvist, 2003; Söderpalm, 2000), but other foreign traders prevailed. The power of the Chinese trading houses was considerably diminished after the two
opium wars that ended with the treaties that forced China to open its borders to foreign trade, empowering especially British, French, Russian and US traders to establish settlements in cities such as Tianjin, Shanghai, Ningbo etc. (Fairbank, 1994). In 1898 Britain expanded their lease on the island of Hong Kong, to incorporate the New Territories and the Kowloon peninsula, not to be returned to China until 1997.

2.3.2 Legal constraints – a new Era for the Trading Houses

Although the power of the trading houses was reduced during the 19th century - the British East India Company lost its royal charter to monopolize British staple trade in 1834 and, as mentioned above, the monopoly of the Chinese trading houses were marginalized as China was forced to open its borders to foreign trade (Fairbank, 1994) - the Chinese trading houses saw a new golden era as China prepared for the reopening in 1978 after almost three decades of communist rule.

The transition from a communist state to a “two systems” state did not go over night; it was an incremental change that is still in progress. To accomplish the gradual reopening of foreign trade, China decided to use a model tested by Japan and Taiwan during their reconstruction in the post Second World War era, where the governments had decided to promote a number of gigantic export intermediaries whose main task was to help local companies to penetrate foreign markets (Peng and Ilinitch, 1998). Thus in the initial stage of the reopening, in order to control the inflow and outflow of goods and money, the government decided to construct five special economic zones where “free trade” was encouraged. More importantly, the government decided to introduce a system of export licenses in order to control the outflow of products from China.

In order to fulfill the Provisional Regulations for the Administration of Foreign Trade, which demanded that all foreign trade activities must be under the control of the government, export licenses were only issued to governmental corporations (Chen, 2008; McClain and Cheng, 1995). The consequence to this was that from 1978 to 1993, if you wished to trade with a non-state owned company or a state-owned company without an export license, you needed an intermediary to handle the payments and transport through customs. It was not until the enactment of the first Foreign Trade Law of the People's Republic of China in 1994, that some privately owned companies that fulfilled certain criteria could apply for an export license (Chen, 2008). Most small manufacturers were still not able to fulfil the criteria set by the government officials which meant that there was still a need for an intermediary to handle the cross border transfers. Not until 2004, with the Revised Foreign Trade Law, did all types of manufacturers gain access to export licenses. The new law introduced two major changes (Chen, 2008). Firstly, it opened up for all corporations, organizations and individuals to
qualify for an export license. Secondly, the process of achieving an export license was no longer through authoritative permits but through registration which meant that part of the power of authorities to decide who qualified and who did not was taken away. Thus, the need for intermediaries has had a declining role in the transition of the Chinese economy.

2.3.3 Hong Kong – Still in the Middle

As described in chapter 1.2.1 Hong Kong received a special position in relation to trade between China and the rest of the world. When the People’s Republic of China was proclaimed in 1949, Hong Kong was still under British rule. The Chinese who fled the mainland, where spread all over the world but some remained in Hong Kong, and as the doors were reopened Hong Kong once again found themselves to be at a golden position in the middle. It provided a gateway into China, where infrastructure had been sadly neglected and where businessmen lacked international experience. Though this has changed, sourcing from China is not always effortless. Despite revolutionary development in communications and remarkable investments in Chinese infrastructure, the hardships of the Chinese business culture are widely proclaimed and discussed (Alley, 2003; Blackman, 1997; Chee and West, 2007; Huitfeldt et al., 2007; Midler, 2010; Nassimbeni and Sartor, 2006b; Pandya, 2007; Vanhonacker, 2004). The entrance into the WTO in 2001 has spurred economic reforms, which has made it easier for foreigners to invest but there is still a long way to go. Although being one of the top ten reformers in 2010 according to the World Bank’s “Ease of Doing Business” ranking, China is ranked 79, which may be compared to Hong Kong that is ranked as number two.

In the statistics on world trade published by WTO, re-export from Mainland China through Hong Kong is still calculated as a separate figure despite almost fifteen years of Chinese governance. The large difference in value between goods imported from Mainland China and the value of the re-exported goods is explained by intermediating services such as logistics and transportation, but above all, intermediaries in Hong Kong seem to be able to influence the price through price discriminations based on the destination of the products.

5 The ranking is an index set up by International Finance Corporation (IFC) and The World Bank. The ranking includes: Starting a business (128), Dealing with Construction permits (153), Registering Property (21), Getting credit (101), Protecting Investors (83), Paying Taxes (168) Trading across borders (38), Enforcing contracts (63), Closing a business (75). In 2006 the ranking also included Employing workers (78),
2 Dragon Suppliers, Viking Buyers and the Intermediaries

2.3.4 Guanxi, Business Relationships and Intermediaries

There is another aspect to intermediaries that is related to Chinese culture and especially guanxi. Many researchers have tried to define guanxi (cf Buckley, Clegg and Tan, 2006; Chadee and Zhang, 2000; Gao, Ballantyne and Knight, 2010; Gu, Hung and Tse, 2008; Li and Lin, 2006; Liu, Li, Tao and Wang, 2008; Lovett, Simmons and Kali, 1999; Millington, Eberhardt and Wilkinson, 2005; Pressey and Qiu, 2007; Sternquist and Chen, 2006; Tao, 2010; Wang, 2007), the concept is usually described as a relationship based on mutual benefits and/or interests (Wang, 2007). One of the aspects that makes guanxi different from relationships in network theory is that whereas the essence of business relationships according to network theory is transactional – it evolves between companies, guanxi is interpersonal (Tao, 2010). Another major difference is that whereas western business relationships are established through interaction over time – Chinese business relationships are established through introduction of a third party – you inherit business relationships through your acquaintance with others (Tao, 2010; Wang, 2007). As illustrated in the case of the accidental intermediary in chapter 1.1.1, the fastest way of establishing business contact is through the contact of others in which case immediate trust is accomplished. Research also shows that these contacts prevail even when the supplier and buyer have established their own relationship and no longer use the intermediary actor that once introduced them to each other. In a study by Pressey and Qiu (2007) the authors show that when Chinese buyers and suppliers decide to dissolve their business relationships it is preferred to involve the intermediating actor that once introduced them to each other.

2.4 Vikings, dragons and intermediaries

The aim of this chapter is to give an introduction to the Chinese market, the special role that intermediaries have had in China, and advantages and challenges from the perspective of western businessmen as described by the practitioners who have ventured China during the 3 decades of open door policy. If we return to the three research questions presented in chapter 1.3.1 the discussion above further strengthens their timeliness.

Research question 1: Why do Swedish SMEs choose to source from China?

The discussion above suggests that for standardized goods and in large volumes the Chinese market has a lot to offer sourcing managers from all over the world. At the same time quality, language and culture might present challenges, which may deter the less experienced sourcing manager in a company with limited resources. It seems that the advantages for the small companies to
Research question 2: How do Swedish SMEs source from China?
Despite their enthusiasm, the practitioners’ stories in chapter 2.2 describe a market full of challenges due to language and culture. Quality, or rather lack of quality, fills the pages of the books. Local representation is highly recommended. Still, the suspicion against the agents and middlemen that have played such an important role historically and still do at times due to the export licenses seems thick. The Swedish SMEs seem to be caught in a dilemma. On the one hand in order to buy small volumes cheaply it seems as if they would need to turn to smaller suppliers. On the other hand this might make them more vulnerable to quality and language difficulties. Swedish companies are in the lead when it comes to establishing IPOs in China. Is this the way that the Swedish SMEs cope as well? How do Swedish SMEs source from China?

Research question 3: What is the role of the intermediaries in China for Swedish SMEs?
Finally, in China intermediaries and especially the trading houses have enjoyed a special status and even after the opening of the Chinese market intermediaries had a legal reason for their existence, the export licenses. Just recently there has been a change in how and which companies may acquire these licenses and it might be expected that more and more suppliers will have export licenses of their own making the agents redundant for that reason. On the other hand, the language and culture dilemma will remain. So, what role do the intermediaries in China have today?
3 In Search of Roles - Study Design

How does one study the role of intermediaries in a Sino-Swedish context? This chapter describes research approach and the collection of data used in this thesis. It describes the relationship between the theoretical chapter, the analysis and how the themes were developed. Finally, it presents some key issues related to the quality of the study.

3.1 The Start of a Journey

Intermediary roles were not the topic I had planned for. In 1996, I came across a then recently published book written by John Naisbitt (Naisbitt, 1996) that would spark my interest for China as a growing market. The overall conclusion of the eight Asian megatrends that were predicted to change the world was that the personal networks linked outside China was creating the foundation of a spectacular market transformation of China and other Asian economies that was predicted to change the world. I was hooked. I began to read whatever literature I could get a hold on, and after my bachelor degree (that focused on the downstream internationalization of Swedish small and medium sized companies) I took the initiative to go to China to study Chinese. Not at any of the partner universities already contracted with Swedish universities where I would be one out of many Swedes, but a fairly unknown university in the outskirts of Beijing were I would be forced to learn the language. I hated it. At least the first week. Then I fell in love. While in China I tried to get some interviews with Swedes who were working in Beijing. These interviews had no real agenda, but were merely conversations about working, living and doing business in China (one of these stories is found in chapter 2.2.1). They were not taped but meticulously written down in my Chinese notebook. Back in Sweden I continued my language studies and wrote my master thesis, which was finished in 2000, again focusing on China. The focus of my master thesis was Chinese business culture as perceived from Swedish businessmen, and as I formulated the initial cast of my dissertation in 2005 and when the first

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6 Translation by the author from Chinese 千里之行，始于足下
interview took place in 2006, Sino-Swedish business culture was still the main focus for this dissertation.

In 2008 I made some interviews for a project by Sören Eriksson concerning why Swedish SMEs outsource production (Eriksson et al., 2008). During these interviews I came to realize that although cultural differences are many and interesting, the respondents were not so eager to linger on this subject. Although they could usually account for situations in which they had encountered some clashes these were considered trivial. If the clashes were too big there would be no business. A review of the research showed an abundance of articles and research on Chinese culture (Blackman, 1997; Buckley et al., 2006; Chadee and Zhang, 2000; Chen and Chen, 2004; Fang, 1999, 2005; Gao et al., 2010; Gu et al., 2008; Li and Lin, 2006; Liu et al., 2008; Lovett et al., 1999; Millington et al., 2005; Pressey and Qiu, 2007; Salmi, 2006; Sternquist and Chen, 2006; Tao, 2010; Wang, 2007; Wiles, 2003) and although very interesting results the studies suffer from the dilemma of using national boundaries to define culture. China is the third largest country in the world and has more than one fifth of the world’s populations – can we really assume that there is only one business culture? The rapid economic development, the “one country, two systems” approach and the large social differences within PRC add to the complexity. Although culture may be defined in many ways it is commonly acknowledged as transmitted through socialization and non-static in the sense that (though slowly) culture evolves through time (Geertz, 1973; Hampden-Turner and Trompenaars, 1993; Hofstede, 2003; Hofstede, Hofstede and Minkov, 2010; Matsumoto and Juang, 2004; Trompenaars and Hampden-Turner, 1997). Some researchers also argue that in times of rapid changes in a society, the challenges on the cultural values and behaviours may affect both the ways in which culture is transmitted as well as the culture itself (Matsumoto and Juang, 2004) which might make this type of research outdated before it is in print. This was also reflected in the interviews in which the respondents often referred to the rapid change in attitude and behaviours among the Chinese suppliers. In the end, as one respondent noted, doing business and making a profit come first and that is one thing that the Swedish businessmen and Chinese have in common. The only cultural difference that they had a hard time to handle was how to induce the suppliers to let them know in advance when a delivery was at risk of running late, a rather practical problem (see chapters 5, 6 and 7). The use or non-use of intermediaries seemed to be the essence of the practical dilemma that the companies were facing. Returning to my own research work I found it interesting that although as explained in chapter 1, intermediaries were frequently argued to be the most appropriate sourcing mode for small and medium sized companies, this research was based on logical reasoning drawn from an empirical data consisting of large multinational companies. Indeed, intermediaries as sourcing mode were in general perceived rather as a temporary mode which the companies were trying to avoid – if they had the resources to do so. The more I read and the further
the interviews went on, the more I wanted to understand why these SMEs chose to source or not to source through an intermediary and how they perceived the role and the functions of the intermediary and in relation to this, how the intermediaries in China perceived their functions and their role in relation to the Swedish buyers. Thus the aim of this research entered a new path that was subsequently followed.

3.1.1 The foundation of a study design

My early readings in cultural studies have had its influence on the study design as a whole. Culture has primarily been studied by anthropologists, sociologists and psychologists, who have created the foundation of knowledge of culture and its influences as we know today. Highly influenced by these readings I did not wish to add to research on how many of the Swedish SMEs that were sourcing directly and how many that use intermediaries for the same purpose, but to understand why these companies choose intermediaries and how they perceived the role and functions of these intermediaries. Considering that the assumption that small companies use intermediaries was based on research on large companies – what do we really know about how and why small companies choose to source from China? Considering that China now experiences a remarkable transition, in terms of economy, the living standards of the people, openness to influence from other countries, etc. I find it to be important that the study is firmly established in its natural setting both in time and place. The aim of this study was thus to explore, an interpretive approach for which qualitative methods are usually most suitable (Bryman and Bell, 2011; Denzin and Lincoln, 2000).

In order to create the holistic view and thick descriptions that often characterize qualitative research (Denzin and Lincoln, 2000; Merriam, 1994) to portray the stories of these companies the empirical foundation of the thesis rests on case studies. In order to increase accessibility and readability, the cases are presented in five themes. One of the reasons for this is that the exploratory aim in combination with the change in focus (from culture to intermediaries) led to an abductive approach, which focuses on the interaction between the theory and empirical data (Alvesson and Sköldberg, 2000; Johansson Lindfors, 1993; Kirkeby, 1994). According to Kirkeby (2000), the abductive approach mirrors the naturalistic way of trial and error, as one theory fails another takes form. The themes that represent the stories of the respondent companies mirror this path in many ways. The first theme addresses the first research question, i.e. why do small and medium sized Swedish companies source from China (chapter 5) and the second theme addresses the second research question i.e. how do small and medium sized Swedish companies source from China (chapters 6) from the perspective of international sourcing. The analysis of these two themes led me to search for theories regarding the functions of the intermediary to further explain what had not been incorporated in the theory of
international sourcing. A further analysis of the empirical data however showed that there were other questions that were more important than that of the functions and activities of the intermediary. This led to a search for theories on intermediary roles that create the fourth part of the tentative model in chapter 4. In this way, roles became an important concept which I had to relate my research to.

3.1.2 In search for roles

The concept of roles holds a central position in this thesis. Although often used without thorough explanation by researchers focusing on intermediaries and middlemen (c.f. Gadde and Snehota, 2001; Mahnke et al., 2008; Marfleet and Kelly, 1999), others have made more or less of an effort to position their understanding of roles in relation to researchers within the fields of sociology and social psychology (c.f. Havila, 1996; Jensen, 2009). Two distinct ways of looking at roles are often distinguished – the structural and the interactionist views (Berg et al., 1977; Havila, Johanson and Thilenius, 2004). Based on the theories of Ralph Linton, roles are more or less taken for granted according to the structuralist perspective (Berg et al., 1977; Havila et al., 2004; Turner, 2001). In an organized system of positions, each position comes with a set of norms or expectations that the individual that occupies the role is expected to perform or learn to perform (Berg et al., 1977; Giddens, 2006; Turner, 2001). Thus the main focus when studying structural roles are the common view of what roles that come with a certain position (Berg et al., 1977), for example intermediaries in general. From an interactionist perspective however, roles are defined within a certain context or situation by the interaction of individuals (Berg et al., 1977; Charon, 2010; Havila, 1996). Roles become patterns of behaviour separating different activities within the group (Hogg and Vaughan, 2005) and from this perspective the question as to how roles emerge becomes relevant (Berg et al., 1977). The key to understanding roles from an interactionist view is thus to understand the situation as defined by the actors and the complex pattern of actions as defined by the actors (Berg et al., 1977; Charon, 2010).

Though intermediaries may be defined as a structural role in the sense that there are expectations and norms that guide the general view of what an intermediary in an international sourcing context is and what activities such an intermediary should perform, it might be argued that these expectations and norms may differ between Sweden and China. There are, as argued in chapter 2, many accounts to suggest that business behaviour differs between these two countries. Adding to this the state of speed of the ongoing transition from a communist market to a semi-capitalist market that China is now experiencing, it might be argued that the role of intermediaries in these Sino-Swedish supply chains and networks are developing in the interaction between actors. Thus, in order to reach an understanding of how the actors within these value chains and networks perceive the role of the intermediary from different perspectives,
3 In Search of Roles - Study Design

that is the perspective of the Swedish SMEs (chapters 7 and 9) and the perspective of the intermediary in China (chapter 8), the empirical foundation of this thesis consists of interviews with these different actors, performed at different locations and sometimes on more than one occasion.

3.1.3 Looking ahead

Although, as explained in chapter 3.1.2, I perceive roles as negotiated between the acting parties and thus intimately related to a particular setting, it does not mean that the interpretive case studies are the only way in which to uncover the perception of roles. Indeed many argue that the combination of qualitative and quantitative may be beneficial to better understanding of a research problem (Bryman and Bell, 2011). Although I find myself inclined to agree with this, I have no epistemological or ontological views that go beyond the present research at hand, this study aims to be viewed as a contribution to our understanding of why and how small and medium sized companies (especially Swedish) source from China and how they and the intermediaries in China perceive the role of the intermediary and not as a new paradigm. Thus this dissertation is but the first step in a journey that will hopefully reach unknown frontiers.

3.2 Research Design and Case selection

Aiming to understand the complexity of how the two types of actors – the Swedish small and medium sized enterprises and the intermediaries – perceive the role of the intermediary when Swedish SMEs source from China it is important that the data is viewed in its context. The data was collected during three years which further allows for understanding of how the perception changes through time and location (see chapter 9).

3.2.1 Multiple case study method

When is a case study design appropriate? Case studies are recommended when studying phenomena within a particular context (Merriam, 1994; Yin, 2008) and are used for exploratory as well as descriptive purposes. This research takes place in the context of international supply chains, and the cases are the actors (companies) within these supply chains. The use of multiple cases has been disputed although Yin (2008) finds that it is an appropriate strategy when a greater variety is sought for or to allow the researcher to visualize contrasts or similarities between cases. On the other hand multiple cases might inflict on the depth of the study. If the number of cases becomes too large and too complex
it might be hard for the researcher to both analyze the material and to represent the material to the reader.

In this dissertation, the multiple case study approach is used in order to portray the abundance of reasons and strategies for sourcing from China as well as the multiple perceptions of roles and relationships. Since the body of previous research on the role of intermediaries within the context of Sino-Swedish supply chains is limited, there is an attempt to contribute to our understanding of these. Yin (2008) claims that through multiple-cases open up for analytical generalization, which means that as the researcher is able to contrast, supplement and substantiate the findings of individual cases, and thus find generalizability to theory that goes beyond the cases in the study. The cases presented in this thesis supplement each other, and though not presenting a complete scale of alternatives – it opens of for a discussion that goes beyond how we today understand the SMEs perception of the role and function of the intermediary.

3.2.2 Selecting cases – getting the snowball rolling

The selection of cases for this thesis follows what is often described as snowball sampling (c.f. Bryman and Bell, 2011) where the researcher through the initial contact with a group of companies relevant to the topic establishes contact with others through these initial contacts. Although snowball sampling is considered to be one form of convenience sampling, Bryman and Bell (2011) emphasize that there are some features that deserves some special attention. As opposed to the traditional convenience sampling where the researcher uses whatever cases are available at the specific point in time, a snowball sampling method is especially appropriate when although impossible to create a sampling frame, it is possible to reach cases through the network of others (Bryman and Bell, 2011). Since it is unlikely that the sample derived from snowball sampling will generate a statistically representative sample, Bryman and Bell (2011) recommend the sampling method to be used primarily on qualitative case studies.

Within the aim of this study there are two sets of challenges that concern the sampling. Firstly, there are no directories of small and medium sized companies that use intermediaries. Secondly, even if there had been such a directory, it would be even harder to find a directory of intermediaries in China who helps Swedish companies. This, in combination with the change in aim (described in chapter 3.1) the initial sampling process was initially created through contacts with a small number of companies, who were willing to let me interview their intermediaries in China.

The first interviews took place in November 2006. The first list of companies consisted of three companies, two of the companies had been contacted earlier by students doing their theses and one was suggested by the head of the Chamber of Commerce in Sweden. All three cases were assigned to
take part in the study by Sören Eriksson (Eriksson et al., 2008). The cases turned out to be more challenging than anticipated. In one of the cases, most of the managers involved in the actual decision and outsourcing process had already left the company several years ago and an extra effort was needed in order to find these people and to get in touch with them. In some cases people left the company, before the publication of the study, which meant that although they were no longer interesting for Eriksson’s study – they were still interesting to me. Some of these individuals had changed their position and/or the company that they had worked for but were now working for other companies that were also sourcing from China. Thus, from the initial three cases – a myriad of individuals, companies and relationships made the list of interviews longer. When a respondent moved to a new position, I followed him. When in China I met with the managers of their Chinese subsidiaries and with their “co-workers”. Some companies were added just because they were positioned in the same region – either in Småland (a region in southern Sweden) or in China. Some were added on recommendation from a respondent for a particular reason or other. Yet other cases were added on recommendation since they had a special way of organizing their supply chain.

The empirical data were gathered in three phases during the years 2006-2009. In 2009 I made some complementary additions to the cases. The abductive approach had led the study away from the focus of motives and modes that were the theory of international sourcing towards theories on functions and roles of the intermediaries. For the first two research questions I found it to be a strength, that the cases were different (see table 3.1). When discussing why and how small and medium sized Swedish companies source from China the differences among the companies highlights the similarities. When trying to convey how these companies perceive the different intermediary strategies – the differences in background suddenly became a factor that was obscuring the differences in strategy. Thus I decided to find two more companies with focus on high quality garments. The reason why I used this industry was twofold – firstly, it is an industry that due to its structure today is more or less without production facilities in Sweden. This makes it highly likely that any company within this industry is sourcing either from China or from another low cost country, which is why making a phone call to ask was easy. Secondly, these types of companies hold the products that should, in accordance to what we know about the structure of the Chinese sourcing market (see figure 2.1) be exactly the type of products that are complicated to source from China, i.e. small volumes of high quality goods.

Although snowball sampling affects the ability to generalize beyond the cases to reach analytical generalisability, the snowball sampling method has brought unexpected data into this exploratory study. It provided me with the opportunity to access special cases – one example of this is the case of the respondent who were interviewed three times – first in Sweden after several years of sourcing from China, then in China after a couple of months when still
struggling to adjust to China and then finally, two years after leaving Sweden for China (see chapter 9). It also allowed me to follow cases in a network through time since one contact led to another. Finally it allowed me to gain access to not only Swedish intermediaries in China but also Chinese intermediaries in China. Gaining access to Chinese companies is not easy, but with the recommendation of the Swedish customers I found myself welcome.

Table 3.1 An overview of the cases (Swedish SMEs)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BTO₁</td>
<td>1982</td>
<td>private</td>
<td>metal</td>
<td>BTO</td>
<td>N</td>
<td>B</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>BTO₂</td>
<td>1964</td>
<td>private</td>
<td>plastic</td>
<td>BTO</td>
<td>N</td>
<td>B</td>
<td>23</td>
<td>59</td>
</tr>
<tr>
<td>BTO₃</td>
<td>2005</td>
<td>private</td>
<td>metal</td>
<td>BTO</td>
<td>N</td>
<td>B</td>
<td>4</td>
<td>37</td>
</tr>
<tr>
<td>DSGN₁</td>
<td>1949</td>
<td>public</td>
<td>metal</td>
<td>design</td>
<td>Y</td>
<td>C</td>
<td>39</td>
<td>92</td>
</tr>
<tr>
<td>DSGN₂</td>
<td>1991</td>
<td>private</td>
<td>textile</td>
<td>design</td>
<td>Y</td>
<td>C</td>
<td>80</td>
<td>163</td>
</tr>
<tr>
<td>DSGN₃</td>
<td>1913</td>
<td>private</td>
<td>textile</td>
<td>design</td>
<td>Y</td>
<td>C</td>
<td>17</td>
<td>115</td>
</tr>
<tr>
<td>DSGN₄</td>
<td>1990</td>
<td>private</td>
<td>textile</td>
<td>design</td>
<td>Y</td>
<td>C</td>
<td>9</td>
<td>94</td>
</tr>
<tr>
<td>OMB</td>
<td>1942</td>
<td>private</td>
<td>metal</td>
<td>OM</td>
<td>Y</td>
<td>B</td>
<td>31</td>
<td>56</td>
</tr>
<tr>
<td>OMC</td>
<td>1994</td>
<td>public</td>
<td>metal</td>
<td>OM</td>
<td>Y</td>
<td>C</td>
<td>20</td>
<td>86</td>
</tr>
<tr>
<td>STDB</td>
<td>1951</td>
<td>private</td>
<td>metal</td>
<td>St</td>
<td>N</td>
<td>B</td>
<td>79</td>
<td>277</td>
</tr>
</tbody>
</table>

There is one case that is a little bit different from the others – that of FSTD which is not in the table above (see chapter 5.4.4). This company is neither Swedish nor Chinese. I did not select it, it selected me. When collecting data in China, I always try to listen to the people around me, asking questions to the Chinese students riding beside me on the bus or the western businessmen that is waiting in the lobby. A western woman travelling alone, dressed for business is still quite rare outside the metropolitan areas and the businessmen and women that are staying for a limited time in China often grow tired of the overwhelming attention they are subjected to. The Westerners often feel as if they are on a 24 hours surveillance program, which means that they are picked up early in the morning, they travel around to meet suppliers and to negotiate
and then dropped off at the hotel after supper, all supervised by an interpreter (an agent or a representative from the suppliers). Quite often it seems that the only person that the western businessmen are able to talk to is the interpreter that follows them along. In the end the constant contact, continuous taxi trips and limited social life take a toll on them. Thus, in the hotel lobby or in a café, as a Caucasian willing to listen to stories about Chinese business life – I tend to be very popular. Indeed I was at one point tempted to think that the best way of collecting empirical data for an analysis of Chinese business culture in the perception of Western businessmen would be to travel around and sit down in various lobbies and just wait for the respondents to show up. In this thesis I use only one of the many stories which I was told during these travels and only in the first theme. The reason is simple – the founder/owner of FSTD explains what other respondents were willing to discuss only after the audiotaping was turned off. Being a non-Swede, the founder/owner of FSTD was not concerned with the policy of conveying his suspicions regarding the prices of Chinese goods. Thus this case was inserted as a special case in chapter 6.

3.2.3 Overview of case companies

As mentioned above there are all in all 20 cases in this dissertation. Out of these companies ten are Swedish SMEs (see table 3.1) and nine are labelled intermediaries in China (see table 3.2) which means that they are located in China though not always Chinese. The names of the companies are changed to abbreviations that are connected to the industry in which they are operating (STD for standard, OM for original manufacturing, DSGN for design, and BTO for built-to-order). All intermediaries are also given names in accordance with their company form. QC for quality centres, Agent for all independent intermediaries that work broader than the QCs, IPO for international purchasing office with RepO (see the appendix) rights only, WFOE for wholly foreign owned subsidiaries.

First looking at the Swedish SMEs, table 3.1 includes the overall information that is of interest regarding the different Swedish companies. The companies are divided into six different categories (see figure 3.1), first of all between consumer goods and industrial goods. More importantly the products are divided into three categories depending on the features of the products.

In the bottom boxes of figure 3.1 are the product for which, as argued in chapter 2, the Chinese market is especially suitable for larger volumes of standardized goods, which is the main business of STDB and FSTD (which was the special case from Ukraine). STDB provides business-to-business products whereas the products of FSTD are standard, everyday household products.

The second category contains the cases that produce products for which the Swedish firm has a patent, which is always risky to outsource. The product of OMC is a worldwide patent that somewhat increases the volume purchased,
although it is not a product found in every household. Quality is of utmost importance due to safety; a faulty product might cause serious damage to the user. OMB also produces standard products for which they have a patent, but sold to business–to-business customers. Although the volumes are not very large for either company (despite the worldwide sales of OMC), the same product assortment is produced year after year which encourages long-term engagements with the suppliers as opposed to the standardized products where there are usually thousands of manufacturers producing similar products. Apart from the patented products, OMC has a line of standard products that they source completely from China.

Figure 3.1 The cases, market and type of goods

The top category contains the products least suitable for sourcing from China according to what was argued in chapter 2. These are the products that are purchased in small volumes, seasonally or for a limited time and with high demands on quality and on time delivery. The category of companies producing designer goods for the consumer market is represented in this thesis by three companies producing functional clothing and one company producing design accessories. These products are produced seasonally, (two seasons per year) which means that if the goods arrive too late – they are unsellable. Functional clothing for the winter season cannot be sold in the summer, nor can they be sold the next winter. The products are also very dependent on high quality which is the signature mark for the design accessory company, and which is
vital to functional clothing in general. If a raincoat does not withstand rain, it is useless. The short life cycles allow these companies to be less protective of the patent since, when the season is over, the same design will not reappear. The products are also suited for the tall Caucasian population of northern Europe and northern America which makes the products less interesting for the Chinese market as a whole.

The final category contains the products that are similar to the design products in the way that they are produced in small volumes, with short production life cycles and with high demands on quality. There is however one more complication with these products. The structure of the sourcing process usually involves a Swedish customer as an actor. This means that there is an inquiry that the BTO company receives, which they then send out to their suppliers in China. When the BTO company receives the offers from the Chinese suppliers, they have to go back to the Swedish customer and who might want to adjust the initial inquiry based on the new information received. Since the inquiry is subjected to competition both between the Swedish BTO buyer and among the Chinese suppliers that receive the inquiry the number of inquiries that lead to order for the suppliers is rather low. Among the Chinese suppliers that receive the inquiry the number of inquiries that lead to order for the suppliers is even lower.

Figure 3.2 The cases, outsourcing and offshoring

Figure 3.2 shows another categorization of the companies, this time from the perspective of having had production or not. In this figure the first category of companies has all had production in China but has outsourced all production, in this sample externally. The second category of companies still has production
in Sweden but has offshored production partially in-house or externally. Finally,
the companies in the third category have never had production in Sweden and
are not presently manufacturing in-house in China or in any other part of the
world.

The intermediaries in China are presented in table 3.2. The aim is to present
a number of different types of intermediaries, independent companies and
subsidiaries and with various types of agreements with the Swedish SME (see
chapter 8). The intermediaries are situated in Hong Kong (HK), Taiwan (TW),
Shanghai (SH), and the neighbouring areas of Shanghai (SHX). In the final
theme (chapter 9) two more intermediaries are included – one in the
neighbouring area of Hong Kong (HKX) and one in Sweden (SW) although the
owner of this intermediary is of Chinese origin. The aliases of the
intermediaries reflect a categorization in itself. Five companies have been given
the name Agent and a number. These companies are independent companies
that work as agents or traders to the Swedish SMEs in the study. That means
that they are more or less handling the whole sourcing process in China, and
thus corresponds to the types of intermediaries that were labelled traditional

Table 3.2 An overview of the cases (Intermediaries in China)

<table>
<thead>
<tr>
<th>Name</th>
<th>Location</th>
<th>Ownership</th>
<th>Nationality of ownership</th>
<th>Nationality of respondent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agent1</td>
<td>HK</td>
<td>Independent</td>
<td>Chinese</td>
<td>Chinese</td>
</tr>
<tr>
<td>Agent2</td>
<td>SH</td>
<td>Independent</td>
<td>Chinese</td>
<td>Chinese</td>
</tr>
<tr>
<td>Agent3</td>
<td>TW</td>
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</tr>
<tr>
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<td>Independent</td>
<td>Swedish</td>
<td>Swedish</td>
</tr>
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<td>Swedish</td>
<td>Chinese</td>
</tr>
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<td>SHX</td>
<td>Subsidiary</td>
<td>Swedish</td>
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<td>WFOE2</td>
<td>SH</td>
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<td>SHX</td>
<td>Subsidiary</td>
<td>Swedish</td>
<td>Swedish</td>
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</tbody>
</table>

QC stands for quality centre. Quality centres are easy to find in China, and are
service centres that provide the type of services that was defined by Nassimbeni
and Sartor (2006) as service intermediaries. The last three intermediaries
represent subsidiaries that are fully owned, WFOEs are equipped with full rights (see the appendix for more information regarding company forms in China). The ownership of the intermediaries also varies in respect to country so that some of the intermediaries in China are owned by Swedish businessmen. In the final column is the nationality of the respondent.

3.3 Data collection - the interviews

An interview is, according to Fontana and Frey (1998), in itself interaction and an encounter which becomes a powerful tool for understanding. The unstructured interview is according to Fontana and Frey especially important when the researcher needs access to a setting, gain trust, locate respondents and in order to understand the language and culture of the respondents. Since understanding is the core of exploratory studies, data were collected through interviews with key informants, in most cases the founders, CEOs or purchasing managers (see table 3.3). A key respondent has been defined as a person in a position from where it is possible to affect the structure and roles in the channel of sourcing and/or essence of the Sino-Swedish business relationship.

Finding the key informants were in most of the cases rather uncomplicated since the companies are small and the turnover of key informants have been low since many of the companies are either family owned or still in the control of the founders. This was also the case with the respondents in China. In one case I had to redo the interview with another key informant. The first respondent that I interviewed at QC2 was one of the Swedish employees. Very quickly I realized that this was not the right respondent since he was not able to answer my questions. At the end of the interview I had however identified with whom I should talk to. In the organization of QC2 it became obvious that the best person to talk to was not a manager and above all not the Swedish employees who seemed very knowledgeable when it came to selling their services but less so when it came to the actual field work which was left to the Chinese employees. Thus, the year after the first interview, I met with a Chinese employee who was working as a quality controller. This last interview was made in spring 2010, a year after the last round of interviews and this is marked in table 3.3 with brackets.

Another complication is that the same respondent may represent more than one company and at the same time many respondents may refer to the same company. This concerns one respondent who are marked by names (which are alias) i.e. Tom (see table 3.3). Tom is the individual that is quoted in chapter 9. At the time of the first interview he was the CEO of BTO1, but soon after the interview he returned to the Swedish company where he had previously been the purchasing manager. This time however he became the purchasing manager for the purchasing office in China.
Table 3.3 Overview of respondents and interviews

<table>
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<th>Position</th>
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<th>06/07</th>
<th>07/08</th>
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3.3.1 The snowball on the move – collecting data

As mentioned above, the data collection for the thesis has been an ongoing process for more than 3 years, but centred in time around five data collection episodes – three in Sweden and two in China (see table 3.3).

Winter 2006- Spring 2007. The first interview took place in November 2006, marking the beginning of the first batch of interviews during the winter of 2006 until spring 2007. The main target was small and medium sized companies in the region of Småland. The respondents were primarily founders/owners and purchasing managers. The material from this round of interviews was transcribed and though some of this material is used in the thesis it really only touched the surface. In one case, that of DSGN1, I had to go a little further to find key respondents. At this company, most of the key respondents from the time of the decision to offshore production to China had been replaced by 2006. In order to really understand what happened in 2006, I decided to locate some of the managers from that time. Eventually I managed to find and interview the CEO and production manager at the time of the decision as well.

Winter 2007-Spring 2008. A year later I revisited the companies that I had already interviewed once and while I did the follow-up interviews, another two companies were added to the list. Two employees had left their former positions and others had taken the positions of those who had left and was added as respondents, bringing their previous experiences to the story. One of the first challenges that I encountered during the first batch of interviews was access to the Chinese contacts. Although some companies were eager to share information about their contacts, some were more reluctant to pass on information regarding their intermediary in China. The aim of the study had also changed and I was now focusing on the companies’ perception of intermediaries. For these reasons I decided to add companies to the study—to find more companies that were willing to let me interview their contacts in China and to find more information from those who had left the companies originally interviewed.

In spring 2008 I also had the first opportunity to go to China and do some primary interviews. The trip was arranged by Sören Eriksson and some of the visits were arranged by him out of his interest in outsourcing amongst SMEs (see Eriksson et al., 2008), and some interviews were arranged by me. This of course meant that for some of the interviews I was merely accompanying Eriksson but he was always generous enough to let me and the other accompanying doctoral student Mikaela Backman, ask all the questions we wanted. As for the interviews I had booked myself, most of them were done on my own, and the contacts were made through the Swedish business contacts I had previously interviewed.

Winter 2008 - spring 2009. A final round of interviews took place in winter 2008 and in spring 2009. Companies were added, some because contacts had
told me their relationships with their Chinese contact was worth the visit, and some to make a better balance in my material concerning consumer goods. My interest for the facilitating companies such as trade councils and representatives of industrial parks and their view on SMEs and their intermediary had also been raised, and thus I contacted representatives of these.

In April 2009 a second visit to China was made, where old acquaintances and new were interviewed.

3.3.2 Structure of interviews

Although Bryman and Bell (2011) make no distinction between structured interviews and standardized interviews, Trost (2010) suggests that the two concepts should be kept apart. The degree of standardization is defined as to what degree the questions were asked in the same way and in the same order at every interview (Trost, 2010). In this thesis the standardization is very low, not only for the obvious reason that some of the interviews were made in English. It was very important for me to follow the story that the respondent wanted to tell, while at the same time keeping track of the questions that I wanted them to answer. Even the interviews that were made in Swedish did not follow the exact order of questions. The interviews were usually made in offices or conference rooms at the case company’s facilities, though even here there were some exceptions. The second interview with Tom for example took place in a café and the third in a secluded area in the lobby of a hotel. Neither of these places was by no means ideal, but rather sprung out of necessity, and both interviews were interrupted. At the same time it might be argued that there are some advantages as to meeting the respondent outside his or her business surroundings, since it might be that they feel more open to talk in a relaxed environment and the interruptions (such as when we were informed that the lobby music could not be lowered until the “music machine manager” returned since the waiter was only allowed to put the music on) may in fact further encourage a more relaxed conversation.

In regards to the structure of the interviews, which according to Trost (2010) refers to both whether the questions are open ended or not and whether the questionnaire is structured per se, one might argue that there is a structure of a kind. My first question usually concerned the respondent (see figure 3.3). He or she was asked to tell me more about him or her, previous experiences of doing business with China, their current position in the company, to describe the work he or she do today etc. The reason was threefold – it gave inspiration to new companies that might be included in the study, it gave me some insight in what experience the respondent had of China, while at the same time allowing the respondent to relax (c.f. Fontana and Frey, 1998; Sjöberg, 2008). Then we moved on to the company, the decision to source from China, how to select suppliers, the use or non-use of intermediaries.
Figure 3.3 Interview guide
Each interview was taped and took about an hour although the span between the shortest and the longest interview was large (the shortest took 50 minutes and the longest 1 hour and 50 minutes), then later transcribed. The reason for this large difference in length of interviews was usually one of two things – the situation under which an interview took place and the amount of small talk that was taking place. Interviews in China often involved a lot of small talk about Chinese food and travelling that were not really part of the interview but part of a process of me getting to know the respondent and vice versa. In addition to this, in the case where the respondent was Chinese I always took asked questions regarding how much they knew about Sweden, Swedish culture and their relationship to the Swedish buyer.

Although the structure of the questionnaire might be described as semi-structured (c.f. Bryman and Bell, 2011), this definition could be questioned. Trost (2010) is very critical towards this term which he finds ambiguous. Indeed Fontana and Frey (1998) do not include semi-structure as an alternative to structured and non-structured. As opposed to Trost who basically defines all interviews with any form of interview guide as structured, Fontana and Frey seem to be less clear about the boundary between structured and unstructured, and the latter is argued to be especially suitable for cross cultural settings and when understanding is a main objective.

In general the interviews were very open. The mind-map structure of the interview indeed served as a map of the general area in which the interaction between interviewer and respondent took place, when the interview strayed too far away it guided us back and made sure that all areas were covered.

### 3.3.3 Transcription of interviews

The first interviews I transcribed as a solid text using spaces only when there was a new voice. This left me with a very compact text hard to analyse in retrospect since much of the meaning was left out. I could not by just reading the text see what emphasis the respondent made on words and sentences. Influenced by Daniel Wästerfors (Sjöberg & Wästerfors, 2008; Wästerfors, 2004), I began to look at the texts in a different way. Instead of writing them all out as compact statements I started to listen to clauses and emphases made by the respondent. In this way I found a rhythm to the text and a flow that was not existent in the first version of the transcriptions. Thus I did not only change the way I transcribed the latter interviews – I re-transcribed the ones that were already finished.

While transcribing I have refrained from using the formal transcription system of Haven (c.f. Kvale and Brinkman, 2009) but instead tried to find a simple system where words emphasized are in italics and empty side strokes // denote that something is left out – either because disturbances make it hard to hear what the respondent is saying or because the respondent is making a note that is not adding to our understanding of the context such as “do you know
what I mean” or “you have probably heard of this before”. I have also used braces [ ] when a word has been replaced by me (such as the name of a person) or when I have made a comment to what the respondent is talking about such as for example when the respondents refer to the names of a person, a company or a place. In some cases the braces also includes comments which refer to non-verbal signals such as laughter. When my question is part of the quote it is marked in bold text.

Transcribing exactly what the respondent is saying is of course hard. Some are gifted with the ability to speak as if they are reading from a book, for the rest of us our language is filled with “paddings”, non-sense making words such as “va” and “mmm” and “ja” and “uhum”. Although at times these words add to the authenticity of the text they did not add to the understanding of what the respondent was trying to convey. If anything the words stole attention from what was really the message, so I decided to leave them out.

Some of the interviews made with Chinese respondent were not taped, by request from the respondent. I then took notes during the interview, which I then typed as soon as possible after the interview took place. Swedish respondents were interviewed in Swedish and Chinese respondents in English.

3.3.4 Categorizing and describing the material

The interviews resulted (as often is the case) in a tremendous amount of rich co-created material (c.f. Kvale and Brinkman, 2009). The unevenness in information partly due to access (what the respondents were willing to share) and partly due to the number of interviews with each respondents in combination with the initial aim of looking at culture, made it very hard to navigate through the empirical data. Thus the initial analysis became an iterative process (Alvesson and Sköldberg, 2000) between reading the transcriptions, writing up cases and reading up on theory to find new ideas or interpretations of the empirical material. Within this process the empirical themes begun to develop.

The question that was most pronounced by the respondents was the question regarding why the companies had chosen to source from China (see chapter 5). This question was rarely asked – it was brought up by the respondents themselves. I always made an introduction to my subject area over telephone as I booked the interviews but I found that in most cases the respondents had only heard “China” and after introducing themselves and their company in general the respondents often made very defensive speeches as to the necessity of the Chinese venture. Thus this theme was partly brought on by the theoretical understanding of motives for international sourcing as well as the urgency among the respondents to discuss this topic. This was also true for the second theme that discusses how the companies begun to source from China (see chapter 6). Most of the companies had already passed the first bumps on the road and the way that they described the start up period was
usually with a sense of pride: they’ve made it. The result was that I ended up with more cases than what was needed to portray the diversity of motives, strategies and roles. Some of the cases were very similar in their content.

Table 3.4 Cases with reference to the chapters 5-9

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</table>
The textile companies for example shared motives due to industry structure. Instead of incorporating all interviews and cases, I decided to focus on the cases that described the alternative motives and start up processes that was found. In this process four cases were removed completely from the study. Information wise they did not add to my understanding of why and how Swedish SMEs source from China. In table 3.4 all cases are listed with reference as to in which chapter they are represented.

Questions concerning cultural differences and/or difficulties in relation to physical distance were often brushed aside. Quality was no problem, not during the first half of the interview. I found that the textile companies were a little bit more open to discuss these issues than the companies in the other industries. Thus instead of going back to do second interviews trying to dig deeper, the third theme became a more in depth study of the supply chains of the design companies (see chapter 7). As the products of these companies’ show similar characteristics it is easier to communicate how strategies differ despite similarities in motives and products. It was when analysing and reading through the empirical material in chapter 6 and 7 I realized the importance of the intermediary when controlling quality. This sparked a search for research first on functions and then on the role of the intermediary. In chapter 8 this theory was used to analyze the perception of the intermediaries on their own role and functions.

Finally, the snowball sampling and recurrent interviews with the respondents of one network left me with material too important to ignore. Not only did the material show how the focal firm (BTO1) strived to redefine the role of the intermediaries in their supply chain but it also raised the voice of Tom, who was able to reflect on the role of the intermediary from two positions (i.e. two different companies and two different geographical locations) at three points in time. It manifests a change that Tom himself had never suspected during the first interview. The first thing that Tom said on our second meeting was that although he did not remember exactly what we talked about a year earlier he was prepared to take it all back. Thus the final theme brings the question of functions and roles together while at the same time displaying the complexity of understanding the same.

3.3.5 The analysis

In an abductive process, the tentative model presented in the theoretical chapter was developed based first on the theoretical understanding of intermediaries from the field of international sourcing and then when the empirical material was analyzed this tentative model was expanded to incorporate other theoretical views of intermediaries. The tentative model contains three boxes that correspond to the research questions. Thus the first box addresses the question as to why companies source from China (addressed in the first theme in chapter 5) and the second box addresses the question as to
how companies source from China in the initial stages (addressed in the second theme in chapter 6).

The final two boxes describe the functions and the roles of the intermediaries. These aspects are addressed in the three final themes – in chapter 7 from the perspective of four small Swedish designer companies and in chapter 8 from the perspective of the intermediaries in China. In chapter 9 the functions and roles are discussed connecting the Chinese intermediaries to the Swedish buyers in a supply chain network and pictured in four points in time. In many ways this final empirical theme is able to display wholeness to the different perspectives on the role of the intermediary.

All in all, the relation between the parts and the whole has been a very important aspect of the analysis and I have tried to maintain an openness to test my interpretations by reversed arguing and to revisions of the tentative model.

3.4 On quality in this study

Ensuring quality in qualitative data is always an issue under debate. Although some researchers such as (Yin, 2008) suggests that one might use the same constructs as for quantitative design, i.e. reliability and validity, whereas others are more prone to find other concepts such as reflexivity, voice and authenticity (Lincoln & Guba, 2000). Reliability refers to the extent to which a study if repeated would yield the same result, and the answer in this case is probably “no”. Considering how companies and respondents were not really sampled but rather found as each interview gave entrance to new knowledge as well as new contacts and the open structure of the interviews, it is highly unlikely that if anyone were to undertake the same study again, the result would be the same. Validity on the other hand, concerns the relationship between the study and the research objective – i.e. if we are sure that what is reflected in the study really shows what it claims to show. This includes the operationalization of concepts, causality of relationships and applicability to similar situations outside the study. In this study there are no causalities and the operationalization of the concepts was guided by the respondents. Whether the findings are applicable to situations outside the study itself is a question that is difficult to answer. While some would say that studies such as this are impossible to generalize, which is of course true, the stories of these respondents do not appear to be so unique that no other companies may find elements of recognition.

In regards to this study in particular I would like to propose a couple of concerns important to this study as it takes place in an intercultural context and considering the way that the interviews were made and the respondents selected. The concerns are (1) the question whether the respondents and companies are representative and whether are able/willing to provide appropriate data, (2) the possibility of misunderstandings or misinterpretations
of the respondents, (3) possible subjectivity of the research influencing the data collection and analysis. All these will be discussed below.

### 3.4.1 Multiple voices (1)

How does one make sure that companies found in the way described above are representative for the purpose of the thesis? There is of course no way of knowing what the result would look like provided another sampling method had been used, but given the advantages yielded for this study discussed above the relaxed way of sampling has generated interesting data. Although the number of companies sourcing from China is increasing, as are the Swedish SMEs sourcing from China, there is still a rather limited amount of companies that are sourcing directly from China. The companies in this study show a great variety in aspects such as length of doing business with China (the company with the longest time frame has been doing business since 1989, merely ten years after the open door policy, which must be considered quite early for a Swedish SME). At the same time, there is always a possibility that the respondents may claim that things are not correct or purposively deceptive. Both of these issues have been addressed through multiple voices. I did not stop at one or a few companies nor have I stopped at one or a few respondents within the companies. The first companies with whom I had contact I made sure to interview not only present employees but also those who held prominent positions at the times when the decision to source from China was taken and afterwards. This meant that I was able to pick up contradictory views between present and past employees at times. This in turn taught me a lot about sourcing from China which in turn sharpened my questions for subsequent interviews. There were however some companies too small and too new to have had previous employees involved in the sourcing process, but then again in these cases there were other similar companies interviewed. In the cases where many interviews were made with the same respondent some questions were repeated.

The attitude towards my study among the companies has also been very warm and welcoming. Most companies were eager to share their experiences from the Chinese market with me and no company that I contacted turned me down completely. Only in one case, where the company had moved almost all production from China already in 2006 did I refrain from proceed to make an interview after the initial contact. The main reason was really that the owner/CEO spent most of his time at the company headquarters in Kuala Lumpur which complicated the interviewing. There was another situation when I later have refrained from using the data. This was an interview in China, where it soon became obvious that the respondent was not the right person to answer the questions most likely because he was quite recently employed. The answers were at times on the border of being completely incorrect and the interview was thus not included in the thesis.
Throughout the interviews I used my knowledge in Chinese and experiences of living six months in China in a very deliberate way. My proficiency in Chinese (Putonghua or mandarin) is far from enough to perform the interviews in Chinese but using a couple of words here and there sometimes seemed to make a difference in attitude. Trust between interviewer and respondent is important, in China maybe even more than in Sweden. I must admit that revealing that I had some knowledge in Chinese and that I had actually lived in China for a short period of time seemed to have some effect on the Chinese respondents, not to mention that I in many cases have visited more places in PRC than some of the nationals. (Truth to be told I had actually visited all of the home cities of the interviews, save Taiwan, which means that they were all city folk.) The effect was in all cases positive. Their attitude changed from a rather cold reception to – after some long discussions on Chinese language and geography which to me were rather safe subjects – eagerness to discussion culture and business life.

When it comes to the Swedish respondents my initial strategy was the opposite. Most “new” respondents seemed to assume that I had never been to China at all and that my knowledge about the Chinese market was low to non-existing. Their reaction was then to teach me the basics of how to source from China and about Chinese business life. I used this strategy to get a grasp of their attitude towards Chinese suppliers and to learn more about what they actually knew. As the interviews progressed however and as the questions became more specific – they usually came to the understanding that I had some previous knowledge of China, which in turn led to a lot of “well you probably know everything about this” fillings, which I assured them I did not.

3.4.2 Misunderstandings and misinterpretations (2)

As described above the interviews were made in Swedish with the Swedish speaking and in English with those who did not speak Swedish. This gives cause to two concerns – first misunderstandings/ misinterpretations during the interview especially when the language was English and misunderstandings/ misinterpretations during the translation of the Swedish transcriptions into English quotes. The Swedish interviews were all taped and transcribed which has given me lots of opportunities to go back and listen again (and considering my change in transcription strategy described above this is what I have done in some cases). Some of the interviews made in English were however not transcribed. Thus I had to rely on the feedback of the respondents on the written material so that they had an opportunity to correct misunderstandings and misinterpretations before printing.
3.4.3 The role of the researcher (3)

As described in chapter 3.1 it is now more than 15 years since I started to develop my interest for China and Chinese business life. To claim any objectivity during these circumstances would be hard. Thus I have tried to use my pre-understanding strategically in the effort to make it a strength as opposed to a weakness.

Throughout the interviews with the Swedish respondents I was not always immediately open about my own relation to China. When the Swedish respondents were approached by telephone to organize the meeting, I introduced my research topic and myself without letting in on any details about ever having been in China. At the interview I always waited until the respondents themselves brought up the question as to whether I had ever been in China, before answering truthfully that I had. I found this approach very helpful – this meant that the respondent would want to tell me all about “how it really is” Once they found out that I speak some Chinese and that I have lived in China for a while they tended to cut their stories short with a “well you know how it is”. I then usually tried to point out that it was such a long time ago, and that much has changed so that they would return to the state of wanting to explain.

In China on the other hand I found this relationship to be reverse – especially when talking to Chinese respondents. Letting them know that I have studied Chinese seemed to make the respondent more willing to share. Thus, I tried to present myself in a way so that my story with China became evident from the beginning.

I have found that with a topic that is related to China it is very hard for the respondents in general to keep distance. Among the respondents I have found those who are I would say “in love” with China, loving everything about China and being very defensive in the way that they talk about China as a country. Others are more jaded, they are of course very positive about the Chinese market and above all about their Chinese contacts, but with mixed feelings in many respects such as communication problems. Although it is very hard to refrain from giving examples of anecdotes similar to those of the respondents and above all not to rush into a heated discussion on Chinese presence in Burma, I did my best to refrain from all this in order not to affect the respondent while at the same time bonding enough for them to tell me more. It does however seem that China is still a very hot topic and once the respondents start to talk, they seem to be able to talk for hours which means that I often did not have to ask so many questions – just encouragingly nod every once in a while – and the respondents would more or less cover the whole interview guide themselves.

As I analysed the material it was equally important to distance myself from the material. The abductive method was a great help in this respect as well. In the continuous process of writing down the cases and writing up the theoretical
framework, I kept returning to the transcribed material where I discovered new angles to add or retract from the cases. In this way I would question the content of each case. This process is however a matter of balance. On the one hand you wish to retract all information that is not absolutely necessary for the understanding of the question while on the other hand being too meticulous would separate the information from the context. This is an exploratory study and I found it to be of importance to look to the context of the respondents reasoning. That is to me the value of a qualitative study as opposed to the quantitative study. I have thus strived to make the descriptions thick, in order to keep as much as possible of the thoughts that the respondents have since I find that they give life to the questions.

3.4.4 Validity and quality in general

Though some researchers question the use of validity in qualitative research (c.f. Jakobsson, 2008) on the understanding that the concept is more suitable for evaluating quantitative studies than qualitative. Cho and Trent (2006) instead argue that the concept may be divided into transactional validity and transformational validity. The transactional validity, according to Cho and Trent (2006) rests on the interaction between researcher and respondent, a strategy by which misunderstandings may be adjusted. In the cases where I interviewed the same respondents several times, the same questions were discussed many times in order to reduce misunderstandings and for the same reason the material were checked by the respondents themselves.

Transformational validity in thick descriptions where generalizations are not strived for (Geertz, 1973) is achieved mainly through descriptive presentation of empirical data and in the researchers ability to make sense of the stories presented (Cho and Trent, 2006). The main reason for the somewhat unorthodox structure of how the empirical material is presented in this dissertation was to enable the reader to access the information without drowning in the information.
4 International Sourcing and Intermediaries

As explained in chapter 3, the structure of this theoretical chapter developed in relation to the analysis of the data collected. The point of departure for this chapter is research in international sourcing and especially on antecedents (especially motives and barriers) and process models of international sourcing. These two form the theoretical foundation for the analysis of the empirical material in the first theme (chapter 5) and the second theme (chapter 6).

The second section of this chapter highlights the subject of intermediaries. It starts with a general definition of intermediaries, followed by four suggestions on how intermediaries may be perceived from the perspective of the theories in international sourcing presented in the previous chapter (S1-S4, see figure 4.9). This is followed by three suggestions on intermediary functions from three other approaches in which intermediaries have been studied, i.e. transaction cost approach (S5), value chain approach (S6) and supply chain approach (S7). The final section of this chapter looks at intermediaries, not as a function but as a role. These suggestions lead up to a tentative model on the functions and roles of intermediaries, which will be addressed again in chapter 10 when discussing the empirical findings.

Table 4.1 An overview of themes and the central questions

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Theme</th>
<th>Central Question/s</th>
<th>Focus</th>
<th>Empirical Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>&quot;The Factory of the World&quot;</td>
<td>Why source from China?</td>
<td>Antecedents</td>
<td>Swedish SMEs</td>
</tr>
<tr>
<td>6</td>
<td>To the Middle</td>
<td>How do SMEs source from China? Why do they use intermediaries?</td>
<td>Internationalization</td>
<td>Swedish SMEs</td>
</tr>
<tr>
<td>7</td>
<td>Organizing for Quality</td>
<td>How do Swedish SMEs perceive the function/role of the intermediary?</td>
<td>Functions &amp; roles</td>
<td>Swedish SMEs</td>
</tr>
<tr>
<td>8</td>
<td>In the Middle</td>
<td>How do intermediaries in China perceive the function/role of the intermediary?</td>
<td>Functions &amp; roles</td>
<td>Intermediary in China</td>
</tr>
<tr>
<td>9</td>
<td>Beyond Dyads</td>
<td>How may roles and functions change in a supply chain?</td>
<td>Functions &amp; roles</td>
<td>Swedish SMEs</td>
</tr>
</tbody>
</table>
4.1 International Sourcing (IS), International Entrepreneurship (IE) and Intermediaries

When this thesis began to take form it was highly influenced by research on international sourcing, offshoring, process models of internationalization and international entrepreneurship. As mentioned in the introductory chapter, the main focus of research on international sourcing may, according to Quintens et al. (2006) and Nassimbeni and Sartor (2006), be divided into two categories – antecedents of international sourcing and the process of international sourcing. Research on outsourcing and offshoring share this interest for the question “why” alongside a focus on potential obstacles that might occur once the decision to outsource/offshore is made. In the overview on research on international sourcing made by Quin tens et al. (2006), antecedents to international sourcing includes research on facilitators and barriers to sourcing, which will be further discussed below.

The second focus is that of typologies and process models, a theme that is not pronounced in research on outsourcing. Whereas the process models that have developed within research on international sourcing, especially the early ones, hold a very strong resemblance to the models developed by the Uppsala group in the late 1970s (Johanson and Vahlne, 1977, 1990, 2003, 2009; Schweizer, Vahlne and Johanson, 2010) the typology models are more linked to the development of sourcing as a strategic tool (Saunders, 1997). In relation to this, international entrepreneurship emerged as a critique to process oriented models of internationalization (Andersson, 2000; Andersson and Wictor, 2003; Knight, 2000; McDougall, Shane and Oviatt, 1994, 2003).

4.1.1 Antecedents of international sourcing

Although innovations in communication (such as the Internet, mobile telephones, email, online video conference etc) and the excess capacity of production that follows the trail of the development in transition economies have led to increased international perspective on sourcing (Christopher, Peck and Towill, 2006; Jansson, 2007; Kotabe and Helsen, 2001; Monczka and Giunipero, 1984), this per se does not automatically mean that all companies now source internationally. The reason as to why some companies choose to source internationally whereas others prefer to stay local has attracted the attention of numerous researchers (Christopher et al., 2006; Lye and Hamilton, 1998; Nassimbeni and Sartor, 2006b). In table 4.2 some empirical research on reasons for outsourcing is listed. The table shows the focus of the research, method and motives that the researchers found to be most important.
Table 4.2 Empirical research on antecedents for international sourcing,

<table>
<thead>
<tr>
<th>Study</th>
<th>Focus</th>
<th>Method</th>
<th>Cost</th>
<th>Focus core</th>
<th>Market</th>
<th>Quality</th>
<th>Skills &amp; Resources</th>
<th>Global Pressure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beaumont and Sohal (2004)</td>
<td>OS**</td>
<td>Survey</td>
<td>X</td>
<td></td>
<td></td>
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<tr>
<td>Bellman &amp; Källström 2005</td>
<td>OS</td>
<td>Int.</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
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<tr>
<td>Cánez (2000)</td>
<td>OS</td>
<td>Case</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Carter and Narasimhan (1990)</td>
<td>Int Pr**</td>
<td>Survey,</td>
<td>X</td>
<td></td>
<td></td>
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<tr>
<td>Eriksson (2008)</td>
<td>OS</td>
<td>Case</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Gillett (1994)</td>
<td>OS</td>
<td>Case</td>
<td>X</td>
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<tr>
<td>Kaufmann and Carter (2000)</td>
<td>IP***</td>
<td>Survey</td>
<td>X</td>
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<tr>
<td>Kinkel and Maloca (2009)</td>
<td>OFFS</td>
<td>Survey</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
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<tr>
<td>Min and Galle (1991)</td>
<td>Int.Pr**</td>
<td>Survey,</td>
<td>X</td>
<td></td>
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<tr>
<td>Monzcka and Giunipero (1984)</td>
<td>Int.Pr**</td>
<td>Survey,</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
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<tr>
<td>Kippenberger (1997)</td>
<td>OS</td>
<td>Survey</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Power, Bonifazi and Desouza (2004)</td>
<td>OS</td>
<td>Survey</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
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<tr>
<td>Salmi (2006)</td>
<td>IS</td>
<td>Case</td>
<td>X</td>
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<tr>
<td>Scully and Fawcett (1994)</td>
<td>IP</td>
<td>Survey</td>
<td>X</td>
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<tr>
<td>Wallén and Fölster (2005)</td>
<td>OS</td>
<td>Survey</td>
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Looking at the results presented in these articles, cutting costs as reason for outsourcing, offshoring and/or upstream internationalization is well documented and mainly attributed to a highly competitive environment.

- 65 -
Whether looking at China in specific (Nassimbeni and Sartor, 2006b), low cost country sourcing (Lockström, 2007) offshoring (Kinkel and Maloca, 2009), outsourcing (Beaumont and Sohal, 2004; Bellman and Källström, 2005; Cánez et al., 2000; Dabhilkar et al., 2009; Di Gregorio, Musteen and Thomas, 2009; Eriksson et al., 2008; Gillett, 1994; Kinkel and Maloca, 2009; Marshall, Lamming, Fynes and de Burca, 2004; Power et al., 2004; Wallen and Fölster, 2005) or international sourcing in general (Carter, Smeltzer and Narasimhan, 1998; Christopher et al., 2006; Kakabadse and Kakabadse, 2002; Min and Galle, 1991; Overby and Servais, 2005; Scully and Fawcett, 1994; Swamidass and Kotabe, 1993), cutting costs seems to be the top reason for sourcing internationally. It might be argued however, that cutting costs is one core activity of the Sourcing Managers in general, which means that it could be a good way to rationalize any decision or strategic intent. Since most of these studies are based on questionnaires that are not published it is hard to see how the question regarding why companies choose to source internationally was addressed, which in turn makes it hard to see what costs that are intended to be lowered by sourcing internationally in general or from China in specific. Studies focusing on China find lower costs to be the main reason but fail to establish what costs that are sought to be lowered by the companies in their study (Au and Enderwick, 1994; Nassimbeni and Sartor, 2007; Salmi, 2005, 2006). In general when it comes to low cost countries such as China, the main cost that is perceived to be lowered is the cost of labour (Carter et al., 2009; Lockström, 2007; Maltz et al., 2011). Labour costs in China are however rising which would possible diminish the attraction of China as a sourcing market, although Fang, Guterberg and Larsson (2010) find that this might be more relevant for companies pursuing a low price strategy than companies that are sourcing long-term.

Costs are not the only motive for international sourcing however. The research in table 4.2 shows that motives such as quality (Cánez et al., 2000; Carter and Narasimhan, 1990; Dabhilkar et al., 2009; Min and Galle, 1991; Monczka and Giunipero, 1984), focus on core competence (Cánez et al., 2000; Dabhilkar et al., 2009; Kakabadse and Kakabadse, 2002; Marshall et al., 2004), search for new skills, material or resources (Beaumont and Sohal, 2004; Bellman and Källström, 2005; Carter and Narasimhan, 1990; Kakabadse and Kakabadse, 2002; Marshall et al., 2004; Min and Galle, 1991; Monczka and Giunipero, 1984; Nassimbeni and Sartor, 2006b; Power et al., 2004) are found to be important. Quality as a motive seems to be dual, on the one hand some researchers find it to be a motive for sourcing while on the other hand it is considered to be a barrier for international sourcing (Dabhilkar et al., 2009) and for backsourcing, i.e. taking back previously outsourced activities (Kinkel and Maloca, 2009). In relation to China, quality has often been questioned (see chapter 2).

There are also other motives related to customers and the market, some indicating a strategic effort to improve service or be close to customer (Bellman
and Källström, 2005; Cánæz et al., 2000; Carter and Narasimhan, 1990; Dabhilkar et al., 2009; Eriksson et al., 2008; Kakabadse and Kakabadse, 2002; Kinkel and Maloca, 2009; Power et al., 2004; Scully and Fawcett, 1994) or in line with an active search for new markets (Eriksson, 1995; Eriksson et al., 2008; Kinkel and Maloca, 2009; Nassimbeni and Sartor, 2006b; Wallen and Fölster, 2005). This would mean that the international upstream activities are linked to the international downstream activities and considering the attraction of the Chinese market with its large population (see chapter 2), it might be reasonable to think that the prospect of enabling export to China might affect the decision to source from China.

The results from the research in table 4.2 also indicate an external pressure (Jansson, 2007; Marshall et al., 2004; Monczka and Giunipero, 1984) as well as changes in industry structure so that the products the company is sourcing are no longer available on the domestic market (Min and Galle, 1991; Monczka and Giunipero, 1984; Scully and Fawcett, 1994) might affect the international sourcing decision. As more and more products are produced in China and other low cost countries, whole industries have been affected (see chapter 2). Within the articles presented in table 4.2, the industry of the respondents is rarely described despite indications that this might affect the answers. Both Lockström (2007) and Kinkel and Maloca (2009) indicate that there is a relationship between type of product or industry and preferred type of market. Lockström, who focuses on low cost country (LCC) markets separate direct products, defined as a component or product required as input to manufacture a finished product (Lockström, 2007) and indirect goods, which is the rest. Although it might be argued that concern for quality, longer lead-times, etc. makes it more risky to purchase in a LCC, this is usually where the major cost savings are possible (Battacharaya et al. in Lockström, 2007). What Lockström find is that although the perceptions of what is suitable to source from a LCC market is not so different among the respondents, quality-critical supplies are perceived as most suitable and supplies with high intellectual property content least suitable. Other researchers also look at the connection between product characteristics and sourcing. Christopher, Peck and Towill (2006) suggest to adjust sourcing approach on the basis of product features such as standard vs. special goods but also to look at demand (stable vs. volatile) and lead times (long vs. short). Fang, Gunterberg and Larsson (2010) find that even within the same industry (i.e. the textile industry) there is a difference between the companies that source low cost products in China and those who had a more long-term strategy in China. Thus, product and industry might be an interesting factor not wholly considered in the studies by Nassimbeni and Sartor (Nassimbeni and Sartor, 2004, 2006a, 2006b, 2007) and Salmi (Salmi, 2005, 2006).
4.1.2 Procurement, Purchase, Sourcing, and Outsourcing

The focus of the research presented in table 4.2 differs between international purchasing, internationalization of procurement, international sourcing, and outsourcing. How might the use of terminology affect the findings?

In Axelsson, Rozemeijer and Wynstra (2005a) and Monczka, Petersen, Handfield and Ragatz (1998) the definitions are used to display the development of the role of the purchasing function within firms. Purchasing has become closely associated with short-term, cost focused buying behavior with strong transactional features (Lockström, 2007; Monczka et al., 1998). Procurement has been used to denote slightly more complex process, involving striving for optimization of materials and logistics (Axelsson et al., 2005a; Monczka et al., 1998). Sourcing, as defined by (Axelsson, Rozemeijer and Wynstra, 2005b), is a far wider concept. It involves not only the operational activities but also the strategies and tactics. The aim is to achieve a competitive advantage through interaction with the supplier, one that could not be obtained had the process been managed internally. Lockström (2007) associates sourcing with supply management and connects it to strategic alliances and long-term time horizons as opposed to the short term horizons of purchasing.

Though the researchers presented in table 4.2 used different words it is unclear how the terminology has affected the sampling of their empirical material. Although it might be easier to understand how these concepts are related to the case studies, the strategic intent is for example not often rarely part of the sampling process of the surveys.

To make it even more complicated, outsourcing and offshoring are frequently used in articles focusing on China. Though outsourcing in its most strict form may be defined as the transfer of any type of production, services or activities from within the firm to other actors outside the firm regardless of the geographic position of these actors (Arnould, 2000; Embleton and Wright, 1998; Mol, 2004), the term has frequently been used for placing these activities in another country or even as equivalent to the activity of a company to start up their own factory in another country (Lockström, 2007). At the same time offshoring, an abbreviation of offshore outsourcing (Bengtsson, Berggren and Lind, 2005), is also defined differently by different researchers. Van Weele (2010) for example, defines offshoring as outsourcing to a low cost country in particular while Bengtsson et al. (2005), based on a report on international trade produced by the US Government Accountability Office, claim that offshoring incorporates in-house direct investments in a foreign country. Thus by the definition of van Weele a new factory set up in a foreign country would not be termed offshoring and neither will the outsourcing of former in-house activities to a developed country, both of which are considered offshoring by Bengtsson et al. (2005). To distinguish between outsourcing and offshoring Eriksson et al. (2008) use a matrix, where the transfer of activities outside the company boundary to an actor within the same country is defined outsourcing whereas
the transfer of activities to actors in another country is named offshoring (see figure 4.1). Transfer of activities to another company but within the same company to another country is defined as relocation.

In table 4.2 the main difference between outsourcing as opposed to sourcing is the make-or-buy decision, i.e. whether to keep the activities within the company’s control or to rely on outside relationships. To outsource production tends to be more complicated that expected for companies since it usually means that they not only have to let go of control, but might also be forced to let go of human resources in the home country (Embleton and Wright, 1998; Hendry, 1995). This has sparked a discussion concerning the transfer of jobs from developed countries and especially in connection with China (Wallen and Fölster, 2005).

![Figure 4.1 Outsourcing, offshoring and relocation defined](image)

**Figure 4.1 Outsourcing, offshoring and relocation defined**

All in all researchers use the definitions differently, and since much of the research concerning China uses the term outsourcing, I have incorporated this type of research, though clarified what term has been used in the particular article referred to (see table 4.2). I also use the term sourcing since the focus in this dissertation has been on companies with a long-term strategy in China but most of all for the sake of consistency. There are cases when this definition might be questioned but that is a question that goes beyond the scope of this research.

### 4.1.3 Antecedents and SMEs

Another issue that might affect the findings presented in table 4.2 is the size of the buyer. It is argued in chapter 2 that the Chinese market with high focus on high volumes of standardized goods might be especially suitable for large companies. Only five of the studies in table 4.2 mention small companies as part of their empirical material (Agndal, 2004; Eriksson, 2008; Kinkel and Maloca, 2009; Min and Galle, 1991; Scully and Fawcett, 1994). Out of these two studies that have incorporated both SMEs and large companies, only Scully and...
Fawcett (1994) attempt to make a comparison. Min and Galle (1991) only mention that among the total respondents 16 per cent of the companies are small and make no difference between large and small companies in the analyses of the empirical material.

Is there anything to suggest that there is a difference between studies focusing on larger companies as opposed to smaller companies? There are studies that indicate that size matters in internationalization patterns and motives (Overby and Servais, 2005; Scully and Fawcett, 1994; Servais et al., 2006). At first glance the results from the studies presented in table 4.2 seem very unanimous despite the fact that some of the studies focus on smaller companies and some focus on larger companies. Scully and Fawcett’s study (1994) is one of few studies where there is an attempt to analyze possible differences between small companies and large companies. What they found was that smaller companies were less internationally oriented and less experienced, and that they, as a consequence tended to act more reactively than proactively towards international sourcing. These findings are also supported by both Agndal (2004) and Apfelfhaler (2000) both of whom also present another aspect, not found in the other studies, which is that of the influence of managerial attitude towards international sourcing.

Thus from the discussion above it remains rather unclear as to why small companies choose to source from China, especially in the light of rising costs. All in all this leads to the first research question presented in chapter 1.3.1 that is why do Swedish SMEs source from China.

### 4.1.4 Process models and typologies of international sourcing

Apart from research on antecedents to international sourcing, there is an abundance of research focusing on process models, typologies and taxonomies of international sourcing.

Relying on the tradition built on research from the 1960s and 70s called the Uppsala school of internationalization (Carlson, 1966; Johanson and Vahlne, 1977, 1990, 2003, 2009) a number of process models focusing on upstream internationalization (sourcing or purchasing) has taken form. One of these is a model developed by Rugman (as presented in Nassimbeni and Sartor, 2006) which bears similarities to the Uppsala Internationalization Model by Johanson and Vahlne. Based on the same factors (i.e degree of involvement and time), Rugman seems to conclude that upstream internationalization passes through five stages, ranging from local sourcing, import through agents or distributors, import through subsidiaries/own representatives, establishment an IPO and as a final stage integration and coordination of global sourcing.

The research by Monczka, Trent and Giunipero has supplied research with many versions of developmental sourcing theories (Giunipero and Monczka, 1990; Monczka and Giunipero, 1984; Monczka et al., 2010; Monczka et al., 1998; Monczka and Trent, 1991; Monczka and Trent, 1992). These models...
differ from the Uppsala internationalization process and the Rugman model in the sense that the first steps are more concerned about how international sourcing becomes a priority for the firm in the sense that they go from local sourcing to international sourcing to global sourcing. Intermediaries are mentioned in two phases. In the first phase where the company source locally it is acknowledged that in the case of international sourcing activities, the local supplier will act as intermediary (Monczka and Trent, 1991). The final stage of the model is presented as five optional strategies for the firm. One of these options is then to use a foreign subsidiary and another to establish an IPO. Thus the use of intermediaries is not a stepping stone but a strategy in itself.

The later model by Monczka and Giunipero (1990) attempts to integrate these two types of models so that the process that is called step I concerns the operational/transactional development from the simple purchase of items through local suppliers, then through external intermediaries and finally through direct contact with suppliers. Step II on the other hand deals with the development from coordination at a corporate level, through creation of organizational structures for international sourcing to finally coordinated management of purchasing in all foreign units.

4.1.5 A typology of sourcing from China

The process models and typology described above are based on international sourcing in general. In addition I have found two sets of typologies that have been adjusted for the Chinese market, one by Nassimbeni and Sartor (2006) and one by Kotabe and Zhao (2002).

The typology developed by Kotabe and Zhao (2002) describes five types of sourcing strategies, based on foreign direct investments. The first type is called Market access which is when the main purpose for the direct investment is to gain access to the Chinese market for selling the products as well as sourcing. The second type of strategy is offshore sourcing which is when China is considered primarily to be a market for production and assembly, and where products are sourced from multiple suppliers. The third type of strategy in the Kotabe and Zhao typology is that of offshore manufacturing. In order to control quality and/or to take advantage of the low labour costs this strategy is when companies manufacture in China, using input imported from home. The products are distributed to markets all over the world. The fourth type of strategy is pursued by companies with products in the late stages of the product life cycle when costs are crucial, and concerns the full transfer of production as well as technology. Finally the fourth type of strategy is called complex sourcing and this is when China is but one part in a global sourcing strategy. In this strategy one supply base does not hold prominence over the others. Thus this typology is based on the strategic intent of the buyer.

The typology developed by Nassimbeni and Sartor (2006) is less complex and is based on three types of sourcing activities that companies choose
between – imposed international sourcing, intermediated international sourcing and finally direct international sourcing. Imposed sourcing refers to the situation when a non-Chinese company by law or by customer is imposed to start sourcing in China in order to be able to sell their products on the Chinese market. The objective for this type of law was above all the transfer of know-how (Eriksson, 1995; Farang, 1996; Nassimbeni and Sartor, 2006b). Nassimbeni and Sartor (2006) conclude that this strategy is only for companies with high and diversified skills, especially to handle negotiations, supplier development and ability to coordinate the local supply network.

The second typology is that of intermediated sourcing. This is of course of special interest for this thesis. The definition provided by Nassimbeni and Sartor (2006, p.74) is “the presence of a third party that interposes between the two ends of the transaction (supplier and buyer)”. Thus it is not explicit whether the third party is an external actor or an internal actor. Within this typology they also make a difference between traditional intermediation (with a Chinese wholesaler that buys products on the Chinese market and resell the products to western buyers) and the outsourcing of international sourcing services. In the latter case the third party provides a set of services. Nassimbeni and Sartor (2006) suggest that this strategy is especially suitable for small volumes and when purchasing skills are low. This category includes intermediaries located outside China that operates in China and, though not explicitly mentioned, this category would also include the western purchasing managers that are operating without a direct investment.

The third and final typology concerns direct sourcing. This includes all type of direct investment in China, thus also the establishment of an international purchasing office (IPO). There are multiple ways to start up a company in China, the most common being WFOE (wholly foreign owned enterprise). An investment of this sort however demands considerable resources (see the appendix) and Nassimbeni and Sartor (2006b) strongly suggest that the companies make use of local partners.

Although these typologies have been adjusted to the Chinese market, the empirical material on which they are developed consists of large multinational companies. Even though Nassimbeni and Sartor suggest that an intermediate strategy is more suitable for small and medium sized companies, they do so based on case studies of large Italian companies. This in turn relates to the second research question presented in chapter 1.3.2, i.e. how do Swedish SMEs source from China.

4.1.6 Beyond process models of internationalization

Since the Uppsala Internationalisation model was first introduced, alternative process models have been presented by other researchers (Nassimbeni and Sartor, 2006b). Although the stages of the process might differ the basic idea is the same – through experience firms alter their international strategy. There
have been critique regarding the model which have caused the researchers to present an article in response to the criticism (Johanson and Vahlne, 2009). In this article the authors protest against the perceived deterministic nature of the stages, by pointing to the possibility that as companies learn more they might step back to an earlier stage or skip some stages and move on. One aspect of criticism that were addressed in all subsequent articles (without a real solution by the authors) was the absence of relational aspects such as trust (Jansson, 2007). In one of the first articles Johanson and Vahlne (1977) describe commitment as the amount of resources invested in the market and the level of integration of these resources in other resources of the firm. As a consequence an external intermediary is defined as low commitment as opposed to foreign direct investment modes which is considered high commitment. The attitude towards intermediaries is softened in the later articles (Johanson and Vahlne, 2003, 2009). Commitment is then defined as a general belief that the other actors perceive the relationship important enough to make the effort to make it long-term.

The relationship aspect of internationalization, starting with early research from, among others, Axelsson and Easton (1992), intermediaries have continued to have a transitional role of facilitating knowledge accumulation and as the second best alternative for firms lacking the resources to commit. Applying the network approach to international activities of firms, means that in order to understand the decisions of the individual firm you have to understand the context as a whole, i.e. the industrial logic, the situation of other actors in the network as well as the nature and strength of the relationships between these actors. Within some industries almost all companies are working on a global basis (such as telecommunication) whereas in other industries, companies are still rather local. Strong relationships to actors with a high degree of internationalisation may open doors (and at time even push you through the door) to internationalisation. Thus the selection of mode and markets are contingent on the contextual factors in the network (Johanson and Mattson, 1982). In an extensive attempt to incorporate the process model of internationalization, institutional embeddedness (especially important when discussing entrance on emerging markets) and network theory, Hans Jansson (2007) developed the International Business Strategy model (the IBS model).

The model consists of five factors, firmly embedded in the environment, that influence the internationalization of SMEs. The first factor concerns the business marketing strategy, that in turn consist of the network strategy (where intermediaries are pictured as part of the vertical dimension), the linkage strategy (which concerns how the seller creates and maintains the actual relationships within his context) and finally the competitive strategy that concerns traditional strategic considerations to maintain and increase competitive advantage in relation to competitors. In this part intermediaries are not reflected upon in any particular way but only one of many actors within the network.
The second factor of the IBS model concerns business marketing processes. Three processes are held to be vital for the internationalizing firm – relationship processes, marketing process and product/service processes. It is in regards to the third factor of the IBS model that intermediaries are discussed. This factor is called internationalization, which is divided into four areas – entry strategy which refers to how firms get access to new customers in new geographic markets. This is not connected to the entry mode but to intermediaries in the sense that they might facilitate this early phase. The second area is entry mode, where intermediaries are treated the same way as in the U-model by Johanson and Vahlne, i.e. a transitional phase to gain knowledge. The third area is entry nodes. Entry nodes refer to the point of entry into a market network that a firm might take. This is where the new suggestion regarding intermediaries takes form. Jansson (2006) suggests that the positioning in a network that is new to the focal firm might be facilitated by the use of an intermediating actor who introduces the new firm at a certain position in the network, which is especially important in many transition economies and emerging markets where it is hard to reach down to operational levels with a translator present and to build actual trust.

The fourth area concerning internationalization in the IBS model relates to entry processes where Jansson (2006) emphasize that although a third actor may be valuable for introducing a company to a new market, the direct interaction between buyer and seller is needed to improve quality and understand customers. In effect, the intermediaries will according to Jansson be temporary modes that has little prospect to develop beyond the initial low. Finally the fifth area concerns entry role, which elaborates on the different roles that an actor may take on the new market – i.e. the role of seller, buyer or producer.

Another two factors make up the IBS model – internationalization process (concerning the continuous globalization of the firm) and Group organization (concerning the actual organization of the global firm). In the final factor the dilemma concerning global integration and local adaptation is discussed. Here Jansson points out that “with an increasing business and number of customer relationships and local hubs in various emerging country markets, the need increases for intermediary hubs between group companies in Europe, for example and local hubs in emerging country markets” (Jansson, 2007, p.211). He further explains that such regional network organizations usually takes form gradually and is institutionalized when the regional activities reach a certain momentum. More and more functions are located at the regional hub, usually starting with sales and then adding administrative functions.

### 4.1.7 International New Ventures and Born Globals

In the late 1990s the process models met another set of criticism. An increasing number of companies that are international from inception caught the interest
of a group of researchers (Andersson, 2000; Knight and Cavusgil, 1996; Madsen and Servais, 1997; McDougall et al., 1994, 2003). Innovations within communications enable companies today to access information and communicate throughout the world, which has facilitated for companies to act on a global arena even with limited resources. New companies although small are no longer constrained to follow the predestined evolutionary paths of the process models. The reasons for this deviation from the path has been attributed to contextual issues (such as industry specifics, technological developments, size of domestic market etc), firm specific issues (such as R&D intensity, market share, ownership, advertising intensity etc.) and personal level issues (managers experiences etc.) (Keupp & Gassmann, 2009).

Three concepts have developed: the Born Globals (BG) (Knight, 2000; Knight and Cavusgil, 1996; Madsen and Servais, 1997), the International New Ventures (INV) (McDougall et al., 1994, 2003), and International Entrepreneurship (IE) (Andersson, 2000, 2006; Andersson and Wictor, 2003) and although the differences between them is mainly related to the definition of the empirical entity, i.e the companies under study. When defining the companies the researchers, apart from size, use parameters such as age (Andersson and Wictor, 2003; Knight and Cavusgil, 1996; McDougall et al., 1994, 2003), per cent of foreign sales (Andersson and Wictor, 2003; McDougall et al., 1994, 2003), competitive advantages such as unique resources (McDougall et al., 1994, 2003) or cutting edge technology (Andersson and Wictor, 2003; Knight and Cavusgil, 1996), and entrepreneurial leadership (Andersson and Wictor, 2003). Just as the early process models (Johanson and Vahlne, 1977, 1990, 2003, 2009; Schweizer et al., 2010; Vahlne, Ivarsson and Johanson, 2010) which is the foundation that is criticized by these BG, INV and IE researchers, these definitions are very downstream oriented although the definition by Madsen and Servais, 1997, could be interpreted as including upstream internationalization as well.

Apart from the tendency to leapfrogging the steps in the internationalization process one of the points that this research elevates is the influence of the founder or entrepreneur (Andersson, 2000; Madsen and Servais, 1997), which in essence separates these small companies from large companies. This dependency on the international experience of management and/or founder is also evident in other research focusing on the internationalization of small companies (Agndal, 2004; Servais et al., 2006). How will this special interest of entrepreneurs and managers affect the choice of mode? This is one of the limitations of these studies on INV, BG and IE. Although they are very specific in defining the companies in the study there is no real consensus as to what level of commitment is needed. Thus although some articles make specific that a certain per cent of sales must be foreign (Andersson and Wictor, 2003) it is unclear whether this sales may go through intermediaries or must be direct. Thus there seems to be no real agreement among these researchers on how to define high commitment. Another question that might be raised in relation to
this research is how high up the commitment ladder the Born Globals, International New Ventures and International Entrepreneurs step (c.f. Madsen and Servais, 1997) and the importance of the relationship to the supplier by others (Knudsen and Servais, 2007).

4.1.8 International sourcing – motives and modes

To sum up what has been discussed above, international sourcing may be viewed as a process in which mode selections change through time (Giunipero and Monczka, 1990; Monezka and Trent, 1991; Nassimbeni and Sartor, 2006b) or as a typology where the choice of mode is made strategically based on resources available and product/industry specifics (Nassimbeni and Sartor, 2006b) or based on motives (Kotabe and Zhao, 2002). In figure 4.3 these perspectives and their relation to motives are summarized. The process models suggested by Monezka and Trent (1991) and Giunipero and Monczka (1990) are, as explained above, based on the development of sourcing from an activity within the firm to become a strategic and integrated tool for the company, and is thus not directly connected to the selection of mode (i.e. type of sourcing activity) in a specific country but internationally in general. To apply it to the sourcing activities in one specific country would be to take the model out of its context. The process model that is represented in figure 4.10 is thus the Rugman model (as presented in Nassimbeni and Sartor, 2006b) that follows the traditions of the original internationalization models by Johansson and Vahlne (Johanson and Vahlne, 1977, 1990, 2003, 2009) which suggest that companies start sourcing through intermediaries in order to overcome their initial lack of knowledge.

Below the process model in figure 4.2 are the two typologies that have been developed especially for sourcing from China, the Kotabe and Zhao model (K&Z model) that is based on the motives of companies (Kotabe and Zhao, 2002) and the Nassimbeni and Sartor model (N&S model) that is based on the company’s resources and product specifics which suggests that small companies should use intermediaries when sourcing from China (Nassimbeni and Sartor, 2006b). Then comes the suggestion from Hans Jansson in the form of the IBS model which suggests that intermediaries might be valuable as a point of entry into a network (Jansson, 2007). Finally, in the bottom box is the suggestion from the Born Global, International New Venture and International Entrepreneurship researchers that even small companies may be born global and source directly from the suppliers (McDougall et al., 1994, 2003). The model is used for further discussion below and in chapter 10.2.
4.2 Intermediaries and middlemen

What is an intermediary? Starting with basic semantics, Collins English Thesaurus defines intermediate using words as middle, mean, in-between and intervening. A definition of intermediaries would then be something like the definition made by Cosimano (1996) who defines an intermediary as a link between organisations and individuals that would otherwise have difficulties to connect.

The question is of course in-between who or what? And why? What marks the beginning of a supply chain and what marks the end? Does it start with the producers/exploiters of the raw material in use or where the product is defined (innovated, designed etc.)? Does it end with the final refinement of the product or where the product is recycled? Using such a wide definition would mean that all companies that are involved in the value chain are intermediaries in relation to the companies before and after the focal firm in the supply chain. This might go against our general understanding of what an intermediary is. Not only would this mean that manufacturers are intermediaries, but also the end consumer who, through recycling, becomes a co-producer of the raw material (c.f. Anderson and Huge Brodin, 2005). Researchers thus have different views on what an intermediary is depending on their approach, which has a profound impact on their research and findings. This chapter discusses at what an intermediary is based on how the concept is understood by researchers with different approaches.
4.2.1 Intermediaries and International Sourcing (IS)

If we go back to the process models of international sourcing we find that intermediaries are regarded as one of the early stages the companies may pass on their way to direct investment (Johanson and Vahlne, 2009; Nassimbeni and Sartor, 2006b). Applied to the context of Swedish SMEs’ internationalization in China, these process models suggest that the companies should gain international experience from closer markets such as the Scandinavian countries, Germany, Europe and USA, before trying their luck on the Chinese market, which is considered to be far both in terms of physical and psychic distance. In terms of mode selection the companies would first start to export through intermediaries, then move on to other entry modes as they gain more experience on the market. This will in the long-term create the trader’s dilemma (Ellis, 2005, 2010) which proposes that an intermediary will eventually make itself redundant as they pass on their knowledge to the clients which they help.

<table>
<thead>
<tr>
<th>Suggestion 1 (S1) Intermediaries for a process view of IS</th>
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<tbody>
<tr>
<td>In the typologies described in chapter 4.1.5, intermediaries were not considered a temporary mode, but a strategic choice. Kotabe and Zhao (2002) suggest that sourcing subsidiaries might be needed in order to control quality in China. Nassimbeni and Sartor (2006b) find that due to the costs of establishing a subsidiary in China, small and medium sized companies are advised to use intermediaries as a long-term strategy when sourcing in China. Thus the second suggestion as to how intermediaries may be perceived according to research in international sourcing is as follows.</td>
</tr>
</tbody>
</table>

| According to the process view on international sourcing an intermediary a is a temporary mode selected by companies in order to acquire market-specific knowledge. Once this has been done the intermediary will be redundant and eventually circumvented. |

<table>
<thead>
<tr>
<th>Suggestion 2 (S2): Intermediaries from a IS typology view</th>
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<tbody>
<tr>
<td>As described in chapter 4.1.6, the process model especially has suffered criticism. Research on business relationships and network theory, suggests that intermediaries may have another role, namely that of creating a position for the entering firm in an already existing network in an emerging country market. This is by Jansson (2007) referred to as an entry node. This leads to a third</td>
</tr>
</tbody>
</table>

| According to the typologies of international sourcing an intermediary a is sourcing mode especially suited for small companies with limited resources. |
suggestion as to how intermediaries may be perceived according to research in international sourcing is as follows.

**Suggestion 3 (S3): Intermediaries according to the IBS model**

Finally the criticism from research on International New Ventures (INV), Born Globals (BG) and International Entrepreneurship (IE) suggests that despite limited resources, small companies do not need to rely on intermediaries in any phase of internationalisation due to the easy access of information and communication the Internet so readily available in China. This would mean that intermediaries would be more of an obstacle in a supplier-buyer relationship than adding value. Thus the final suggestion in regards as to how intermediaries may be perceived according to research in international sourcing is as follows.

**Suggestion 4 (S4): Intermediaries from INV and BG perspective**

The four suggestions above may be summarized in the matrix in figure 4.2 (S1-S4 stands for suggestion 1-4).

**Figure 4.3 Overview of Intermediaries from IS perspective**
On the vertical axis are the three views on intermediaries – intermediaries as a mode (Giunipero and Monczka, 1990; Monczka and Trent, 1991; Monczka and Trent, 1992; Nassimbeni and Sartor, 2006b), a node (Jansson, 2007) and the third alternative presented by the international new venture and born global researchers which suggests that intermediaries are superfluous (Andersson and Svensson, 2009; Andersson and Wictor, 2003; McDougall et al., 1994, 2003). In the case of intermediaries as mode, there is a discussion among researcher whether intermediaries are a long-term solution or a temporary solution to gain experience. The same might be argued when it comes to intermediaries as entry nodes, thus suggestion 3 is divided into long-term (S3b) and temporary (S3a).

4.2.2 **Intermediaries and Transaction Cost approach (TCA)**

The concept of intermediaries have enjoyed a long life in the elaborate calculations of researchers within the field of economics and originally as part of a channel of distribution (c.f. Gattorna, 1978). The interest in distribution channels (and through this for intermediaries) has undergone a huge development from the micro-economic calculations to behavioural theories focusing on the relationship between actors. In the early channels there are three types of actors: the end user, the manufacturer and the intermediaries (see figure 4.3) (Coughlan, Anderson, Stern and El-Ansary, 2001; Ju, Linn and Zhu, 2010). Transaction cost theorists try to determine the logic of using intermediaries based on the rational economic advantage that might be achieved. Trying to solve the “make-or-buy” dilemma, the transaction cost approach (TCA) argues that firms will continue to grow as long as the cost of organizing one more transaction internally is less than finding the same transaction on the open market (Gattorna, 1978; Hollensen, 2007). Hollensen defines transaction costs as the effects of operating in a non-perfect market, i.e. the “friction” between the buyer and seller that occur because each part behave opportunistically (Hollensen, 2007). In the international perspective this friction concerns costs that appear prior to an international venture (ex ante costs) as well as costs associated with an ongoing relationship such as monitoring and enforcement costs (ex post costs) (Gattorna, 1978). Especially the ability to lower negotiation and/or monitoring costs, is found to be behind successful intermediary performance in export trade (Peng and Ilinitch, 1998; Peng and York, 2001; Trabold, 2002).

![Figure 4.4 Simple channel of distribution](image-url)
From this discussion, two issues stand out as representative of intermediaries. Firstly, an intermediary is a member but not a channel designer. The intermediary is not actively changing the structure of the channel but provides a to buyer and/or seller. Secondly, an intermediary is perceived as a channel member that performs certain tasks more efficiently and/or at a lower cost for the benefit of a channel designer. Although the intermediary offers its services to the channel designer, they themselves do not design the channel.

Suggestion 5 (S5): Intermediaries from TCA

4.2.3 Intermediaries and the value chain approach (VCA)

The channel perspective described above is sometimes criticized for over simplifying a very complex decision. Apart from the difficulties in actually finding what costs should be in the equation it also fails to take into account other managerial aspects of decision making such as maintenance of market share, competition and contextual uncertainty (Gattorna, 1978). This in turn shifted the focus from the make-or-buy decision to look at the relationship between the actors. The research on supply chain relationships has moved through a functionalist phase focusing on power and control to reflect other behavioural aspects such as, for example interdependence and trust (c.f. Geersbro and Vedel, 2008; Huemer, 1998). The focus has shifted from the channel as a whole to the dyadic relationships between two actors, regardless of their position in the channel as a whole. The end and beginning of the focal dyad is no longer defined by the manufacturer and end-user, but more commonly by the seller and buyer. The intermediary has become either marginalized or defined as either buyer or seller.

At the same time the importance of the customer rose to the attention of researchers. Influenced by researchers such as Michael Porter the channel developed into a value chain (Christopher, 2005; Porter, 1985). The essence in this new approach was the focus on the end user, and a managerial effort to align the supply chain in accordance with the demands of this end user (Baker, 2006; Christopher, 2005). The focus here was to integrate not only the internal activities, but to reach external integration where linkages and co-ordination was extended to upstream suppliers as well as downstream customers (Christopher, 2005). With this the distribution chain was divided into upstream and downstream activities, integrated under a common goal of serving the end user.
The value chain approach postulated a processual view on the supply chain with members integrated to serve the end user in a competitive way (Christopher, 2005). The functions and activities of the concept were discarded. Instead Coughlan, Anderson, Stern and El-Ansary (2001) use the word flow in order to emphasize this processual view. Thus the eight flows that, according to Coughlan et al. flow through the marketing channel include physical, possession/ownership, promotion, negotiation, financing, risking, ordering, and payment. Although usually pictured as flows running through the whole channel, Coughlan et al. find that specialization among the channel members on these flows is “the hallmark of an efficiently operation channel” (Coughlan et al., 2001, p. 10). In accordance with this the intermediary may take part in all the flows or specialize in one or many of the flows.

Coughlan et al. (2001) also separate between downstream and upstream flows and discuss the benefits of intermediaries from two sides. From the perspective of the buyer (i.e. upstream) the intermediary may provide assortment, accessibility (physical and time wise) as well as facilitate search and comparison. On the other hand, from the perspective of the supplier (i.e. downstream) the intermediaries may above all provide efficiency through routinisation of transactions and reduction in number of contacts (Coughlan et al., 2001).

Suggestion 6 (S6): Intermediaries according to VCA

4.2.4 Intermediaries and Supply Chain management

While the power of the downstream middlemen grew stronger the view on the market as homogeneous is challenged by some researchers (Hägg and Johanson, 1982; Stern, 1988). The opposite – heterogeneity - would mean that firms are operating on a market where the offer is not only a product, but a combination of products and services that makes the offer multidimensional and thus harder to compare (Hägg and Johanson, 1982). The choice between offers is further implicated by relationships that evolve between buyer and seller through time. Networks and relationships are based on the assumption that increased cooperation between companies will lead to a collective development of a superior product. Since the productivity of a group is not only dependent on the productivity of each actor, but also on how well these actors work together – mutual adjustments may facilitate cooperation, at times it may even be necessary in order to develop (Hägg and Johanson, 1982). At the
same time, specialization amongst actors also increases dependency since the higher the level of specialization the greater the likelihood that you will face a need to complement functions. In effect the companies evolve in relation to the other companies in the network. A consequence of this heterogeneity according to Hägg and Johansson (1982), is that it becomes hard for the individual actor to retrieve sufficient knowledge about the counterparts. Decisions are made based on what the individual actor knows about the network as a whole, thus introducing the research on network horizons (Anderson, Håkansson and Johanson, 1994; Holmen and Pedersen, 2003). The intermediaries that have been marginalized and questioned by the researchers focusing on the value chain, were thus back in focus as research on triads (i.e. constellations of three actors in a relationship) as opposed to dyadic relationships (based on two actors) emerged.

Interaction research have discarded both the terms flow and functions, for the benefit of the term activities (Axelsson and Agndal, 2005). In research on dyadic relationships there is very little room for discussions on what intermediaries do. In the triadic relationships, however, the intermediaries were reintroduced, this time as a third actor in the relationship between a buyer and a seller. The amount of research on triads is still fairly limited (Geersbro and Vedel, 2008; Havila et al., 2004), most of which focus more on the relationship side to the triad than the activities of the actors. Havila (1996), although focusing on the changing structure of the triad, reach the conclusion that intermediaries in an international context are not likely to disappear as they are needed by both seller and buyer, among other in order to overcome language difficulties. Geersbro and Vedel (2008) find that downstream intermediaries were valued for their knowledge, solution and customization for end users which compensated for the added cost of an intermediary. The supplier is perceived as “a partner on the product, the knowledge and increasingly in logistics” (Geersbro and Vedel, 2008, p.10). Ronström (2005) find that although the roles of the intermediaries differ, their main contributions are knowledge, experience, trust, competence and access to the right network. All in all, the triadic approach is more concerned with the relationship between the different actors than the actions performed in the triads.

Thus within the supply chain perspective, intermediaries are viewed as actors within a business triad that are neither the buyer nor the seller, but perform certain activities for the benefit of the end customer (Geersbro and Vedel, 2008). In their study, Geersbro and Vedel (2008) expand the number of possible activities which an intermediary might be involved in to include six types of activities: Production (price, quality, time of delivery), Logistics (stocks, assortment and coordination of deliveries), Financial (safeguarding on product guarantees, liquidity, risk), Knowledge (of products in assortment or portfolio of suppliers), Indirect (market, scout, innovation, social) and Administrative (billing, coordination of purchases). Their findings suggest that product knowledge and logistics are important activities to integrate with the
intermediary whereas in regards to some activities such as pricing the result is not so conclusive. On the one hand some respondents were sure that the intermediary could negotiate better prices whereas on the other hand the extra expenditure of the intermediary was questioned (Geersbro and Vedel, 2008).

Suggestion 7 (S7): Intermediaries from supply chain approach (SCA)

4.2.5 Intermediaries in a larger context

Despite the influence of interactional views by researchers as Bagozzi (1975) and despite all contributions from network theory, the main focus remains on the dyads in particular and only in some cases on triads (cf. Blankenburg and Johanson, 1991; Havila, 1996; Havila et al., 2004; Pardo and Salle, 1994; Trimarchi and Liesch, 2006). Although the researchers acknowledge the influences of other relationships on the actors in the triads and dyads and subsequently on the relationships between these actors, trying to incorporate all these influences in one study seems to be very complex. In a wider context, beyond the dyads and triads, in a network of independent and interdependent actors, who are intermediaries? In the channel structures and triads, the intermediary is defined by their position, in the first case the position between a manufacturer and an end user and in the second case in between two other actors. In a network there is no beginning and no end, and thus the intermediary is hard to define by position. Indeed, network research seems to denounce that a network may consist of natural boundaries at all since all firms are interconnected through direct or indirect relationships (Holmen and Pedersen, 2003). This in turn has led researchers to define arbitrary boundaries such as network context, network horizon and network environment. Network contexts are all actors perceived as important by the focal firm which is defined by the current strategy and interests of the focal firm (Anderson et al., 1994; Holmen and Pedersen, 2003). The network horizon creates the boundary within which the firms that are acknowledged to be part of the network by the focal firm are confined (Holmen and Pedersen, 2003). Companies beyond the business horizon although not part of the current strategy and interest of the focal firm may still affect the actors and relationships within the business horizon, but this is beyond the view of the focal firm. These companies belong to the network environment. What is the strategic importance for the firm to overview the whole network? Holmen and Pedersen (2003) find that small companies due to limited resources rest on a fairly limited view of the network.
Instead, companies tend to rely on their counterparts for information crucial to the company’s strategy. In this sense these companies, regardless of being manufacturers or end users and regardless of actual position in the network environment, become intermediaries to the focal firm in the sense that they mediate and transfer information from outside the horizon to the focal firm. The conclusions of Holmen and Pedersen is thus that a firm should analyze the efficiency and effectiveness of the mediating function of their counterparts (Holmen and Pedersen, 2003). Looking at the network as a whole, the intermediary is thus regarded by Holmen and Pedersen as neither a position nor a member, but a role in relation to a focal firm, working at the fringe of the focal firm’s network horizon.

In research mapping networks rather than focusing on dyads or triads, there is little discussion on the topic of the intermediary as a type of actor in the network. There are, however, interesting research mapping the embeddedness of internal networks in external contexts that look at the subsidiaries in relation to headquarters (Andersson, Forsgren and Holm, 2002; O’Donnell, 2000; Roseira, Brito and Henneberg, 2010). Just as Ghoshal and Bartlett did in 1990, these researchers map the extended networks of the multinational company to map international dependency and social control (O’Donnell, 2000), horizontal integration and buyer power (Roseira et al., 2010) and the impact of the subsidiaries’ external networks on the large companies (Andersson et al., 2002). Most of these studies mentioned above look at subsidiaries and not on external, independent intermediaries.

4.2.6 Intermediaries – roles and functions

Research on intermediaries offers three other approaches on what an intermediary is and what they do. All suggestions presented above are summarised in table 4.3 below. The research does not seem agree in regards to the value of intermediaries, short-term or long-term, although a long list of what functions and activities that they perform may be listed. Supply chain management literature and network theories on internationalization look at the intermediaries within the context of a web of actors, which means that an intermediary might be any actor in-between two other actors. The transaction cost approach however makes it clear that a channel member is not a channel designer thus excluding the companies that have the intellectual property over brands or products. Regardless of perspective researchers seem to agree that the intermediary perform certain tasks, functions or activities as a service to other companies. These services might include search for new suppliers, inventory, merchandising, pricing, persuasion, physical distribution, logistics and/or as in the case of an international supply chain language and culture translation (Burt, Dobler and Starling, 2003; Havila et al., 2004) and/or, in the case of China in particular, contact with the government (Nassimbeni and Sartor, 2006b; Salmi, 2005).
Table 4.3 Intermediaries from different approaches.

<table>
<thead>
<tr>
<th>Approach</th>
<th>What do Intermediaries do?</th>
<th>Key Concepts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Process view</td>
<td>Temporary stepping stone to acquire market knowledge</td>
<td>Entry mode</td>
</tr>
<tr>
<td>2 Typologies</td>
<td>Mode especially suitable for small companies with limited resources and experience</td>
<td>Strategic mode</td>
</tr>
<tr>
<td>3 Network</td>
<td>A point of entry into a new web of relationships</td>
<td>Entry Node</td>
</tr>
<tr>
<td>4 INV /IBG</td>
<td>Not needed</td>
<td></td>
</tr>
<tr>
<td>5 TCA</td>
<td>Ex ante costs (i.e search costs, negotiation costs) Ex post costs (i.e monitoring and enforcement costs)</td>
<td>Transactions</td>
</tr>
<tr>
<td>6 VC</td>
<td>Assortment Accessibility (physical and time) Facilitate search and comparison</td>
<td>Flows</td>
</tr>
<tr>
<td>7 SCM</td>
<td>Production Logistics Financial Knowledge Indirect Administrative</td>
<td>Functions as a set of activities</td>
</tr>
</tbody>
</table>

Figure 4.5 shows a summary of how the intermediary as a function from the perspective of the transaction cost approach, value chain approach and supply chain approach that led up to the three suggestions (S5-S7) may be viewed.

Figure 4.5 TCA, VCA and SCM approach to intermediaries
4 International Sourcing and Intermediaries

4.3 Intermediaries and the concept of role

The studies presented above, regardless of perspective, seem to look at the intermediary as a service provider that offer certain activities, functions or flows to channel designers. There have been a number of attempts to look at the role of the intermediary (Anderson, Havila, Andersen and Halinen, 1998; Gadde and Snehota, 2001; Havila et al., 2004; Jensen, 2009). In order to have a discussion on what the role of an intermediary is we first have to reach an understanding as to the meaning of the concept of role. The aim of this section is to create a foundation for the basic understanding of the concept of role and how it relates to relationships, which is another important concept within supply chains, all of which will be further discussed in relation to intermediaries in a Sino-Swedish context.

Within sociology two different schools of thought have developed regarding roles, i.e. the structuralist and the interactionist (Anderson et al., 1998; Berg et al., 1977; Havila et al., 2004; Turner, 2001). This subchapter will thus start by introducing the concept of role from these two perspectives.

4.3.1 Structuralist view on roles

When looking at the social system as a network it may appear to be an system of organized positions and relationships appear to have a stable structure (Berg et al., 1977). Within such a network norms and expectations are attached to each position that directs the individual that uphold this position in what to do and how to act (Berg et al., 1977; Heidegren and Wästerfors, 2008; Hogg and Vaughan, 2005; Linton, 1936; Turner, 2001). Within a group the roles represent a division of labour while giving the members a self-definition and place within the group through elevating expectations not only on behaviour but also on motivation, attitudes and feelings along with information about how the different actors relate to each other (Hogg and Vaughan, 2005).
Table 4.4 Types of sourcing intermediaries (according to Burt et al., 2003)

<table>
<thead>
<tr>
<th>Types of Intermediaries</th>
<th>Relation to Other Actors</th>
<th>Activities</th>
<th>Terms of Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import merchants</td>
<td>Exclusive</td>
<td>Buy goods for their own account and sell through own outlets</td>
<td>The difference between buying and selling price</td>
</tr>
<tr>
<td></td>
<td></td>
<td>All activities concerning the movement between markets</td>
<td></td>
</tr>
<tr>
<td>Commission houses</td>
<td>Partly exclusive</td>
<td>Act on the part of an exporter abroad</td>
<td>Commission from the exporter</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Billings usually directly between buyer and seller</td>
<td></td>
</tr>
<tr>
<td>Agents / representatives</td>
<td>Exclusive or partly exclusive</td>
<td>Represent the seller</td>
<td>Commissioned by seller</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Assume no responsibility for the principals</td>
<td></td>
</tr>
<tr>
<td>Import brokers</td>
<td>Non-exclusive</td>
<td>Locate buyers/sellers</td>
<td>Commissioned by seller</td>
</tr>
<tr>
<td>Trading companies</td>
<td>Exclusive or partly exclusive</td>
<td>Agents operating on a world wide basis</td>
<td>Commissioned by seller</td>
</tr>
<tr>
<td>Subsidiaries</td>
<td>Linked to one of the actors through ownership</td>
<td>Depending on organisation, employees and internal regulations</td>
<td>Depending on internal regulations</td>
</tr>
</tbody>
</table>

Transferred into a business setting this means that there are certain expectations as to how a businessman acts in negotiations. Although we in general accept cultural differences there are still some basic expectations that we carry as universal such as that the main objective of a chain is to bring value to the customer and thus the customer is always right (Gesteland, 2005). Since the structural view on roles arises from the group, organization or society in general, the guiding question is how to integrate the individuals into the set roles rather than how to adjust the roles to the individuals (Berg et al., 1977).

One way of transferring these structural roles to the intermediaries that the Swedish SMEs use when sourcing from China is to look at the specifications of types of intermediaries that may be found in most textbooks. Thus, you are able to find listings of different types of intermediaries such as for example in Burt, Dobler and Starling (2003). Within the supply chain, Burt, Dobler and Starling list six different types of global trade intermediaries, distinguished by the relationship to the surrounding actors, the terms of payment and the
actions they perform (see table 3.4). The relationship to the other actors may be exclusive (no or very little interaction between buyer and seller other than through the intermediary), partly exclusive or non-exclusive where the main objective is to hand over the relationship as soon as the agreements have been fulfilled. Terms of payments that are displayed in table 4.4 may indicate both the level of independence as well as the possibility for the intermediary to make extra profits through mark-ups. If the terms of payments are hidden, i.e. when the seller is as unable to see the price that the intermediary charges the buyer and the other way around, the intermediary is able to adjust prices to their benefit. These intermediaries are labelled import merchants by Burt, Dobler and Starling (2003) which might be related to the findings of Feenstra (2004) that discussed the mark-ups made by Hong-Kong intermediaries. Apart from the subsidiary the other forms of intermediaries are in one way or another commissioned which means that the price of the services are negotiated between intermediary and commissioner. In the list of intermediaries provided by Burt, Dobler and Starling (2003) the intermediaries are commissioned by the seller, which indicates that the buyers are not in focus. The commission houses and import merchants add the dimension of location since they are not located in the same country as the seller, and are closer geographically to the buyer. The dimensions of these different types of intermediaries are summarised in figure 4.5.

Figure 4.6 dimensions of Intermediary roles from a structural perspective

### 4.3.2 Interactionism and roles

So how do interactionist roles differ from structuralist roles? The main difference according to Berg (1977) is that for the interactionist the foundation of roles arises from the actual interaction between individuals rather than a social system. Based on the theories of Herbert Blumer the foundation of interactionism is the basic premise that individuals use symbols to communicate with others and that through reading and interpreting the symbols from others we mutually anticipate responses and adjust our behaviour in accordance
Thus, argued Peter J. Burke, when individual behave as we expect them to behave trust as well as commitment will increase (Turner, 2001). It is the mutual understanding and definition of the situation that allow roles to take form. The roles are that are formed as rational actions (emotionally rational, value rational or goal rational) become habitual (Berg et al., 1977).

One of the classical theories in interactionism and roles is Erving Goffman (Heidegren and Wästerfors, 2008; Turner, 2001). The most important contribution that Goffman has on our understanding of roles is the front region/back region theory. In its essence this theory postulates that social life may be divided into a front region that is a certain contextual performance that may be compared to what is happening on stage in a show, whereas the back regions are hidden from the other actors (Goffman, 2004 (1959)). In the back regions we may prepare our performance and relax from the expectations of others. Thus there is a clear distinction between the self and the role in that we take on a role as we enter the front region. This way of understanding roles gives rise to the fundamental attribution error which is when individuals attribute the characteristics of a role on the individual (Hogg and Vaughan, 2005).

Although interaction may take place between two actors, in order to talk about an intermediary there is a need for at least one more actor, thus moving from the dyad to a triad. In empirical studies what is to be considered a triad may differ. The main concern is whether there is a need for a direct relationship between all actors in the triad or not. Blankenburg and Johanson (1991), for example, accept triads even when there is no interaction between the manufacturer and buyer. Haviala et al. (2004) on the other hand define triads as relationships involving some degree of interaction between all three parties. Based on the research by Yamagashi et al. (1988, in Haviala et al., 2004), argues that just because two independent actors (S and B) both have a relationship to a third actor (I) does not mean that they are a network triad. In order to be considered a triad there must be some sort of connection between the two relationships (S-I and I-B) so that one relationship affects the other and vice versa. On the other hand it may be argued that there is in a network a direct relationship for one actor to affect the other.
Figure 4.7 Triadic relationships (Havila, 1996; Hogg and Vaughan, 2005)

This does not however mean that all relationships within the triad are equally strong or equal in any other way. Havila (1996) describes two different sets of triads – the serial and the unitary (see figure 4.6). Although the relationship between two of the actors in the serial triad may affect the relationship between the other two members, this connection might be indirect. This is further elaborated on in an article by Havila et al. (2004 p.175) in which, based on arguments from the sociologist Georg Simmel, the authors describe a triad as a collaboration where “each of the three parties functions as an intermediary between the other two”. An intermediary then becomes not a member positioned between two ends but an addition and/or an influence on a relationship. These relationships also affect the role of the intermediary according to Havila (1996). In the case of a serial intermediary the role of the intermediary becomes that of a mediator due to the limited contact between the other two actors. In the case of a unitary triad the role becomes more connected to activities and is unique in relation to the other actors in the triad. One of the classical theories is that of Georg Simmel (Heidegren and Wästerfors, 2008). Simmel studied the roles within groups in relation to the number of participants in the group. As a dyad (two actors) becomes a triad; three actors) Simmel postulates that there are three possible roles that the third actor might take, that of the impartial negotiator, the exultant third (which is when the first two rival at the gain of the third) and finally the divide-and-conquer role which suggests an active separation of the other two (Heidegren and Wästerfors, 2008).

As mentioned in chapter 4.2.4 within international business studies, empirical research on triads are still limited (Geersbro and Vedel, 2008; Havila et al., 2004), and if only counting those studies where all three parties have been interviewed even fewer. The study by Havila (1996) does look at international triads in an international context and concludes that intermediaries are necessary and will most likely not disappear from most relationships. In the cases in her
study the companies tended to change the activities in the relationships but keep the relationships.

When it comes to research that is not empirically founded are some interesting ideas. Using a triadic approach, Gadde and Snehota (2001) suggest that there are three different roles in which intermediaries may create value to the buyers and suppliers – i.e. the role of the trader, the distributor and the provider. This typology is primarily based on intermediary’s relationship to the other actors in the triad. The trader is thus perceived as an autonomous actor that seeks out new opportunities on the market, and brings offers from multiple sources to those who are willing to pay. The distributor is usually more closely connected to the supplier, offering its services to one or a few suppliers in handling multiple customer relationships. Finally, the third role is that of the provider, whose main contribution is that of bundling the offers from multiple suppliers into collective offers directed to one or a few customers (see figure 4.7).

![Diagram](image.png)

**Figure 4.8** The Gadde and Snehota typology of intermediary role in triads (Gadde and Snehota, 2001)

### 4.3.3 Towards an understanding of intermediaries in triads

Combining the dimensions of intermediaries presented in figure 4.4 with the triadic approach, gives rise to many alternative types of intermediaries. The Gadde and Snehota (2001) typology presented in figure 4.6 combines the commissioned (c) dimension, though including the intermediaries that work on
commission for the buyer with serial triads. There is however no unitary triads in the typology presented by Gadde and Snehota (2001) though it cannot be wholly rejected that the same typologies would work in unitary triads as well as serial triads.

Looking at the other three dimensions, these may also be added to the understanding of serial and unitary triad (see figure 4.6). The fist dimension (a) regards the relationship between the actors in the triad which means that the exclusive or partially exclusive relationships would suggest a serial triad, whereas a non-exclusive would indicate a unitary triad. Subsidiaries are by nature closely connected to the parent company though in a study by Havila (1996) subsidiaries are include in the empirical data as triads. A triad with a owner relationship might however be either unitary or serial, depending on the relationship between the parent company and the third actor. The second dimension (b) is part of neither the study by Havila (1996) nor the study by Gadde and Snehota (2001) but adds an interesting aspect. As could be seen in table 4.4, Burt, Dobler and Starling (2003) added payments a one way of assessing the relationships between buyer, seller and intermediary. If payments are hidden the possibilities for the intermediary to set their own prices increase. In a unitary triad it is hard to keep the costs and negotiated prices hidden the way that it is possible to do in a serial triad with little or no communication between buyer and seller.

![Figure 4.9 Typology of intermediary roles in triads expanded](image)

Figure 4.9 Typology of intermediary roles in triads expanded

The final dimension (d) concerns the geographic position of the intermediary that in this case might be Sweden or China. This dimension is not mentioned in the studies referred to above but could there be a difference between the role of an intermediary situated in Sweden and the role of an intermediary situated in China? All in all figure 4.8 combines the typology dimensions presented in figure 4.5, adding the buyer in the commission dimension, with the models of serial and unitary triads.
4.4 A tentative model of intermediary roles

The purpose of this thesis is to create an understanding of the role of the intermediary when Swedish SMEs source from China and the aim of this chapter is to give some basic insights in how intermediaries may be viewed from different perspectives. In chapter 1.2.1 three research questions are presented. In order to sum up this theoretical chapter these three questions are revisited.

4.4.1 Why do Swedish SMEs source from China?

According to the research presented above the main reason for companies to source from low cost countries, a category to which China belongs, is the costs (see figure 4.9). The research above is based on empirical material of large companies and, considering the specific features of the Chinese market such as focus on standardized high volume products, the question remains whether low costs are the main reason for Swedish small and medium sized companies as well as large multinationals. A number of other reasons for companies to source from China are suggested, such as quality, market access, external pressure and focus on core activities (see figure 4.9) and it is not clear what the relationship between the different motives is. What made the company take the decision to outsource? This research question creates the foundation for the empirical material in the first theme (chapter 5) and will be further discussed in chapter 10.1.

4.4.2 How do Swedish SMEs source from China?

As presented above, within international sourcing two types of theories for upstream internationalization is discussed – the process models and the typologies. Whereas the process models present a framework that suggests that companies move from local sourcing, to low commitment modes (such as sourcing through an agent) and towards high commitment modes (such as foreign direct investments), the taxonomies suggest that companies based on factors such as strategic intent and size are expected to use a certain mode when they source. Thus Nassimbeni and Sartor (Nassimbeni and Sartor, 2004, 2006a, 2006b, 2007) suggest that small companies use intermediaries when sourcing from China, and whereas Kotabe and Zhao (2002) suggest that the strategic intent (such as market access) affects the choice of mode in China. Just like research on antecedents these theories are based on empirical data from large multinational companies. The question is then how do Swedish SMEs source from China? This research question creates the foundation for the empirical material in the second theme (chapter 6) and is further discussed in chapter 10.2.
4.4.3 The role of intermediaries when Swedish SMEs source from China

The second and third sections of this chapter are devoted to the concept of intermediaries. Figure 4.10 gives a tentative model of the different perspectives on intermediaries and summarizes the suggestions presented in the grey boxes above (suggestion 1-8) and incorporates figures 4.3, figure 4.5 and figure 4.9. The first cell on the top to the left contains the suggestions regarding intermediaries from the perspective of international sourcing. It suggests above that from this perspective intermediaries might be perceived as either a short-term solution in order to overcome the initial shortage of knowledge about a new market (either as a mode or as a node) or as a long-term solution, creating the matrix that was also presented in figure 4.3.

The cell to the top right contains the three suggestions from the transaction cost approach (TCA), value chain approach (VCA) and supply chain approach (SCA) that discussed the functions of intermediaries to the buyer. Finally the bottom cell summarizes the discussion on the intermediary as a role (which becomes the final suggestion, S8).

This research question creates the foundation for the empirical material that is presented in three themes in chapter 7, chapter 8 and chapter 9. Each chapter look at the intermediary from different perspectives. In the theme “Organizing for Quality” (Chapter 7) four Swedish SMEs with seasonal design products of high quality present their strategies for sourcing from China and how they perceive the role and functions of the intermediary. The theme “In the middle” (chapter 8) presents the perceptions of the intermediaries in China on their roles and functions in regards to the Swedish SME buyers. The fifth theme “Beyond dyads” looks at the role and functions of intermediaries set in a supply chain and how the perceptions on the intermediary change. In chapter 10.3 the tentative model presented below is revisited and creates the foundation of the concluding discussion regarding intermediaries as a function and as a role.
Figure 4.10 Tentative model on intermediary role and function
Theme
Factory of the World
5 On why Swedish SMEs source from China

As discussed in chapter 4, motives for international sourcing are one of the areas that have received much attention from researchers. According to researchers, the main reason for low cost country sourcing, and in effect sourcing from China, is to lower costs, although other reasons are found to be important (see figure 4.2). Previous research focuses however mainly on large multinational companies and is based on surveys. The findings are usually not related to any specific destination and do not provide an answer as to how the different motives are related to one another. The question “why” creates the foundation of this chapter, the stories of how the decision was made, transcends beyond the make or buy decision disclosing both fascination for and hesitation towards the Factory of the World. The chapter begins with a brief introduction, followed by the summaries of the respondents’ stories. The chapter ends with a summary and a preliminary analysis of the motives expressed in the cases within this chapter.

5.1 Why sourcing from China?

The purpose of this thesis is to create an understanding of the role of the intermediary in the context of Swedish SMEs sourcing from China. Looking at the research on intermediaries there seems to be an ambiguity as to the actual value of intermediaries in a sourcing context. On the one hand they may facilitate functions such as bundling and translations while on the other hand, they are an added cost, one which most researchers agree companies will strive to get rid of. Especially so if costs are the main reason for the decision to source from China in the first place.

What reasons do Swedish SMEs have for choosing China as a market for sourcing? The motives presented by previous research are summarized in the tentative model in figure 5.1. Although, as elaborated upon in chapter 3, there is an extensive amount of research on why companies choose to source internationally in general and from China in particular, all of which seems to point to the direction that costs are one of the main priorities. In relation to the motives of Swedish SMEs sourcing from China there are however two major question marks. One of these question marks refers to the empirical data that focuses on large enterprises and though other studies suggest that there is a difference in motives among small and large enterprises. The second question that one has to ask oneself after reading the research on motives for
international sourcing, which is mainly based on surveys, is what do costs really mean and how is it related to other motives. If avoiding costs and raising income are the main priorities of a company would it not be natural to select lower costs as a main motive? Besides, most of the other alternatives might be related to the alternative of costs. Indeed quality, or in particular the lack of quality, is a cost in itself. Focus on core activities might in its essence be explained in terms of avoiding the fixed costs of machines and facilities. Thus, it is hard to know what the respondents mean when they claim that lower costs are a reason for choosing to source internationally. Besides, considering the idea that small companies buy small quantities, often custom made, can the costs really be lower, considering that the competitive advantage of Chinese manufacturers are mainly built on large quantities of standardized goods?

![Motives to sourcing from China](image)

**Figure 5.1 Motives to sourcing from China (see chapter 4)**

### 5.2 Build-to-order goods for the Business Customer

The first category of companies presented here deals with built-to-order goods mainly for Swedish customers. Two of the companies work with metallic components (casting, welding, sinter etc). The third company produces plastic components, but in contrast to other two companies, this company (BTO2) still has manufacturing in Sweden. This means that the decision to source components from China was affected by their commitment in Sweden. This is also the only company in this study that has chosen to set up their own production alongside an office that serves as both sourcing and sales office.

The BTO companies are especially interesting, since most of these companies work with rather small volumes and, since many of their customers are comparatively large, are especially vulnerable to high costs. These are the stories of the BTO companies.
5 On why Swedish SMEs source from China

5.2.1 The vision of a production line – BTO₁

The business idea for this company began to evolve in the mid-80s. The Founder grew up in a region in Sweden known for its entrepreneurial spirit and many family businesses. The structure of the metal component market then was that of many small companies all specialised in doing one part of a complex product. This meant that the customer had to not only set up a contract with multiple suppliers but also make sure that the product went smoothly through the supply chain. The idea was to find a supplier large and flexible enough to do all the stages of a complex component with a quality that was accepted by the Swedish industry but still cheap enough to be competitive. The first choice was India, due to previous business contacts. Almost a year and half later the project was terminated. Despite the previous contact the culture clash with India turned out to be too large for the Founder.

The Founder then looked around at low-cost markets geographically closer to Sweden. Visits to Estonia and Poland left the Founder unimpressed. Factories in Eastern Europe in the late 1980s appeared to be far too passive and uninterested in doing business. In 1989 the Founder came in contact with a manufacturer of small metal locks and tags in Hong Kong. In 1989 Hong Kong was still the most common gateway into China, and the manufacturer offered the Swede to find manufacturers in China who were able to produce the requested quality at a good price.

Thus the main reason for deciding to source internationally was the structure of the market rather than just the price. What the company needed was manufacturers able to produce at the scope wanted and be flexible in terms of production methods so that they could offer a whole product. The reason for choosing China above closer alternatives seemed to be a combination of cultural factors and luck in the sense that they found an agent that was willing and able to help them out.

International sourcing was the core business idea, and when asked the Founder and CEO state that sourcing from China is absolutely accepted even in the part of Sweden, known for its cluster of small entrepreneurial companies, where this company is situated. When the question is altered however, when asked where the major customers are situated, he confesses that most customers are not in the region. The actively seek customers further away as to not become direct competitors to the small entrepreneurs in the region.

5.2.2 The Fair Deal – BTO₂

In late 2004, the owner and the CEO of BTO₂ was approached by one of their major customers at a Subcontractors Trade Fair. BTO₂ had, in cooperation with the customer, developed a certain tool for a component that up until now had been used in the customer's production plants in Sweden as well as other sites all over the world. Thus BTO₂ had for years exported the component to the
Chinese production plant of the Swedish customer. Now BTO2 was informed that due to the costs of transports and import taxes the customer had decided to start sourcing this particular component in China for the Chinese factory. During their discussions with the customer the picture gradually became clear to the representatives of BTO2. Either they would have to start up production in China or let their customer find a local supplier in China that would produce the co-designed tool for the Chinese factory. Even if they took the chance to let the Swedish customer use the tooling to produce the component in a Chinese factory with the promise that they would continue to source directly from Sweden to all other factories in other parts of the world, BTO2 realised that it would not take long until the customer would start trying to send their overproduction to these sites. Before too long BTO2 would be replaced all together.

There was no explicit demand or even a wish from the customer, but the Owner and the CEO of BTO2 reached the same conclusion. If they choose to let go of the design and production they would face some serious threat in the future. The customer made no official request and emphasised that the decision to start production was completely up to the Swedish supplier. The customer did however provide the security of a first order, signed in Sweden for components produced in China in a factory not yet built.

Now the factory in China is producing mainly for the Chinese market. Overproduction of standard goods has been shipped home but at the time of the interviews there was a clear strategy not to let the Chinese factory drive its Swedish sister factory out of business. Thus the strategy has been to strengthen the Chinese factory with a sales manager to boast sales in China.

5.2.3 The Business Partner – BTO3

In 2004 the two Founders of BTO3 found themselves to be restlessly looking for something else to do. They were both working at the same company, a mid-size trading company supplying mainly standardized goods to industrial customers. Like many third part logistic (3PL) companies they also supplied some BTO goods produced internationally to their main customers. Through this job the Founders of BTO3 had come into contact with a Chinese supplier. The contact person of this Chinese supplier had however plans of his own. He decided to start up his own factory – starting from scratch, which in turn sparked an idea in Sweden. The two colleagues decided to resign from their current positions and start up on their own. At first they sold almost anything that they found a Swedish customer for – the contact in China helped them out. In just a couple of years they managed to get the company profitable by working very closely with the main contact in China. Their basic idea is to sell industrial BTO goods using the argument that they have a very proficient supplier. Indeed the division of work runs smoothly making full use of the time difference. The Swedes approach a customer, asks for a draft that they send to
China. Before the next morning there is a CAD drawing in the email box together with suggestions on how to make the component even cheaper.

5.3 Designer Goods for the Consumer Market

Just as the BTO companies above, the designer good companies struggle with small volumes. All four companies focus mainly on the Swedish market for their products, although three of the companies are starting to build up their export – concentrating mainly on the countries similar in culture but even more importantly physically (tall, with broad shoulders and fair complexion) in order to increase the volumes of each collection. Three of the companies design functional clothing while the fourth design other types of fashion goods for consumers. In this section, the design companies are represented by DSGN₁, DSGN₃ and DSGN₄.

5.3.1 The Volatile Consumer – DSGN₁

It is not only the sub-suppliers to industrial customers who have felt the heat of their customers’ breathing down their neck. Consumer oriented companies also feel that they have to respond to the demands of their customers. At the turn of the century DSGN₁ had finally turned a couple of years of adversities into success. Sales were starting to pick up, efficient production with new machinery lowered the cost of production and the turnover was increasing. The CEO of 20 years looked forward to his retirement. A year later the picture was completely different. Interviews with the people involved in the decision create a picture of a rather complex situation.

First, there was a change in both attitudes and preferences among the consumers. The perception of the product changed from function to fashion, much like the change that happened in to the wrist-watches in the 1980s. The customer suddenly wanted a fashion statement rather than a function, which meant an increased focus on design but also a larger assortment of products to fulfil a more segmented market in terms of preferences. Prior to this turn of events, there had been two types of materials used for production. The demand had slowly turned from one material to the other, mainly due to changes in preferences. Now the customers demanded a selection of both.

This change in turn gave rise to a new buying behaviour among the customers. Customers started to shop around, instead of just consulting an expert. The change in customer preferences coincided with a change in the structure of the retail market. In the past a few, established “professional” retailers bought the products from the different manufacturers to provide a
good selection for the customer. At the beginning of the century, new actors made their entrance on the Swedish market, and the competition, especially from the web shops, became fierce. As a response, many of the retailers began to buy goods directly from low cost countries to provide a selection of cheaper alternatives for the customers.

The effect on the producers were of course a major pressure to lower costs but above all to find flexible production to follow the demands of the customers. Although Design1 held the competence for both design and production, the newly bought machinery could only master one of the materials used and the old machines that could master the other type of material were not efficient enough to get economies of scale. With an inventory filled with un-sellable products, the new CEO and the new Production Manager faced the ungrateful task of making a complete organizational redesign. Just weeks into his employment, the Production Manager was sent to China to look for a supplier. The choice of market was given. The Production Manager roughly estimates that 80% of all the products in this industry are made in China, which was the case already at the turn of the century. The first round of lay-offs begun in 2000 and over the years the company went from 80 employees in 2000 to the current 30+. All production is offshored to China. The suppliers are by Swedish measures very large and are able to adjust their production to shifting demands of the consumers on a worldwide basis. The flexibility of the Chinese factory would be far too costly to imitate in Sweden.

5.3.2 Starting Small – DSGN2

The Founder/CEO of DSGN2 also had a vision. Part of his vision was to find a well-paid summer job. What he found was a business. The embryo of his enterprise was summer open shop opened during summer selling the type of clothing that is in demand in small coastal towns that is invaded by summer guests every year, that is mainly sportswear and leisure clothing. In addition to the clothes, directly imported from Asia to keep costs down, a number of clothing lines from sport brands were added.

As the summer job grew into a permanent job, thoughts of a high quality, low price apparel line of functional clothing, aimed for active families begun to take form. Following the trail of the brands already in store and his own experiences in Asia, China became the natural choice. Although most of the shirts and sweaters were imported from Thailand, DSGN2 found out through contacts with other companies in the same industry that functional clothing was to be purchased from China, making the choice easy.
5 On why Swedish SMEs source from China

5.3.3 The Volatile Consumer – DSGN₄

DSGN₄ started off producing special collections for extreme events, producing their first clothing lines in Sweden. Although situated in a region known for its textile industry, this strategy had to be abandoned when the collections grew large. The capacity among the few local manufacturers still left could offer neither volume nor price. It becomes a vicious circle. As more and more manufacturers in the region outsource their textile production to low cost countries, it becomes harder to find manufacturing capacity locally. Especially when it comes to the use of special textiles – such as Gore-Tex. Good substitutes for Gore-Tex is increasing, but in general the manufactures need a licence to be able to produce clothes in patented fabrics. Thus the fabric patent holder will control which companies manufacture clothes using their fabric, which in turn limits the selection of suppliers for these goods. There are today no manufacturers of Gore-Tex in Sweden, which provides little alternative for DSGN₄ but to source internationally. Though DSGN₄ still used manufacturers in Portugal and Poland for this type of fabrics they found that while more and more manufacturers in China becomes licensed the number of licensed manufacturers in Europe is decreasing.

5.4 Standardized goods and non-seasonal goods

Standardized goods and products that, although patented, run season after season seem to be the perfect match for the Chinese manufacturers. There are no adjustments or deviations from normal production. The volumes that are demanded from small and medium sized companies are however not always large enough to be interesting for the Chinese manufacturers. Still, compared to the companies above, the buyers of standardized goods find themselves in a far better situation in one other respect – the selection of possible suppliers. In China there are thousands of suppliers for these types of products. This means that in theory it would be easy to go from one supplier to another to find the best offer. In this section the buyers of standardized and non-seasonal goods are represented by STD₈, OMC, OM₉ and FSTD.

5.4.1 In Defense of Intellectual Property – OMC

Intrusion on intellectual property rights is often listed as one of the hazards of producing patented goods in China. The reactions to these types of questions were usually met with patience among the respondents. Indeed, one of the respondents simply stated that if you have ever presented your products at a European trade fair and the product is good enough to be interesting in China
it is likely that there already is a copy available. The best way to actually protect your intellectual property is to be in China.

For this next company, nothing could be truer. For a small company in a world where information travels fast, defending a patent may become both costly and time consuming. This was the situation that faced the new external CEO of OMc. Despite winning most of the lawsuits and a successful attempt to extend their product line to better suit consumer preferences, the company found it harder and harder to cope with the number of copies that was flooding the market.

The company was faced with the reality that their products were not better in quality than the copies, but their prices were far higher. The gap in pricing between the original and the copy was considered far too wide. The company had to develop a new strategy based on lowering costs while keeping the same quality in order to keep a strong brand.

One of the tasks for the new CEO was to track down copy cat manufacturers in Asia and especially in China. As the company managed to track down 25 copy cat manufacturers in China, another strategy started to take form.

One of these copy cat manufacturers was producing a product that was almost superior in quality to the Swedish original. When approached with the patent, the manufacturer acted immediately to stop the product. This was enough to induce the CEO to pay a personal visit to the manufacturer, contact was established and a year later he is the sole licensee to produce the product. Thus the company now has a partner in China that is actively making sure that no copies are made in China. This however means that there is no manufacturing left in Sweden.

5.4.2 The Sub Supplier's Nightmare – OMb

Among the small and medium sized component manufacturers in Sweden, dependence on a few large customers is a reality. To become a main supplier to a company such as Ericsson, Tetra Leval, IKEA, SAAB or Volvo is a mixed blessing. On the one hand, despite constant pressure to lower costs, the contracts usually became the source of a long-term income while on the other hand; it is possible that they became too dependent on that one supplier. They spend years of building relationships and co-designing products for one or few customers and this takes up most of their production capacity. But what happens when the large customer decides to move their production to other markets or start sourcing from low cost countries?

In 2000, OMb found themselves in a most odd situation. After a very successful year in 1999, the company had decided to invest in new facilities and new production lines to better suit the demands of their customers. The investments were calculated to cost somewhere between 30-35 million SEK. Then, according to the CEO, rather suddenly they realised that their major
5 On why Swedish SMEs source from China

customer, responsible for approximately 30-40 per cent of the turnover, had exchanged their products for very similar products – purchased in China. According to the Manager of the Chinese subsidiary it was a copy. Seemingly overnight they lost their major customer and were faced to reconsider their future strategy. It became a question of survival.

The loss of the customer was a real wake-up call – despite a seemingly good relationship with the customer, despite all investments in co-design; in the end low costs had driven the customer to find other suppliers. What would prevent the other customers to act the same way? Feeling a very strong opposition towards outsourcing, OMB started up by sourcing the components in China for production in Sweden. This meant leaving behind their former suppliers in the region. Their second decision was to start sourcing a supplement of low end products for their product portfolio. They decided not to outsource any of the components produced in the Swedish factory but rather supplement their existing assortment with a low cost alternative made in China.

Once the decision was made, they were faced with a new insight. Just as suggested by OMB, the cost of material was far too low for the Swedish manufacturer to compete with. Though they decided to make fresh calculations on every product, comparing the costs of producing in-house in Sweden as opposed to outsourcing to Chinese suppliers the Swedish factory lost in most cases.

They [the Chinese suppliers] use a type of recycled material, and their prices are completely crazy. We can’t even round up the material. It is no use even to start the machine and it is not just any machine; it is a machine that is able to assemble a component like that under a second but we did not even get to that part before the calculation was exceeded

(CEO of OMB)

Despite automated production in Sweden they are not able to meet the low costs of the Chinese suppliers.

5.4.3 The Customer is King – STD

STD is a family owned SME and although constantly looking for lower costs, the company was at first hesitant to take the step. By 1997 rumours that competitors were already buying their products in China spread while at the same time customers were starting to ask for products from China. The Founder pushed forward but the newly appointed Purchasing Manager hesitated. Above all he felt that communication would be a serious problem. The Internet and email had not yet made their big entrance into Chinese companies, and the level of English skills at small Chinese firms was still limited. China, he concluded, was for big players. In order to keep the quality stable, they decided instead to develop their sourcing skills in cooperation with
two German companies – first sourcing from Germany and then three years later sourcing in China in cooperation with the two German companies.

5.4.4 The Odd Case – FSTD

FSTD is not like the other cases in this study. As mentioned in chapter 3, FSTD is a Ukrainian company whose CEO I met during one of my visits in China. In the early 1990s when the Soviet Union fell apart, the Founder/CEO of FSTD had already accumulated a considerable amount of experiences in doing all sorts of business. When the market finally opened for official trading he was already looking around for a product to sell. The main idea was to find a foreign product at a reasonable price to sell within Ukraine. He found his niche and had managed to become one of the major suppliers of a particular FMCG (fast moving consumer good) in Ukraine. All products are produced in China by a set of suppliers, no patent is held by FSTD.

Although from a low-cost country by Swedish comparison, he claimed that there was absolutely no use producing his products in Ukraine. The costs were too high. When asked if the difference in labour costs really were that large between China and Ukraine. He simply smiled and commented that it was not the labour costs; it was the costs of the raw material. Without any proof, the Founder/CEO of FSTD, was absolutely convinced that the low prices of the raw material was subsidized by the Chinese government. It could not be explained solely on the basis of inferior material. This suspicion has been confirmed by many other respondents.

The low prices on ray material have also caught the attention of the European Union, that launched an investigation in 2007-2008 that ended up in a 70% tax on all fasteners imported from China. Still, respondents claim that although this tax has been a severe blow against the import of the products in question, the products are still cheaper in China than in Europe. Besides, as they consider leaving the Chinese supplier it will not be to the benefit of European competitors but rather other low-cost countries in Asia.

5.5 On motives for sourcing in China

Before looking back at previous research, let’s look back on the explanations that the Swedish SMEs in this study made for their decision to start to source from China (see figure 5.1). The table contains the key words of the respondents found in chapters above.

The motives are picked out as they are presented, first of all in relation to the motives presented by previous research but also the motives that were not presented in previous research, such as management interest.
Table 5.1 Motives for sourcing from China – Empirical data revisited

<table>
<thead>
<tr>
<th>Name</th>
<th>Market</th>
<th>Motives</th>
</tr>
</thead>
<tbody>
<tr>
<td>BTO₁</td>
<td>B2B</td>
<td>Lower costs, Flexibility, Mgmt interest</td>
</tr>
<tr>
<td>BTO₂</td>
<td>B2B</td>
<td>Lower costs, Customer pressure</td>
</tr>
<tr>
<td>BTO₃</td>
<td>B2B</td>
<td>Lower costs, Contact, Management interest</td>
</tr>
<tr>
<td>DSGN₁</td>
<td>B2C</td>
<td>Lower costs, Flexibility, Mgmt Interest, Global pressure</td>
</tr>
<tr>
<td>DSGN₂</td>
<td>B2C</td>
<td>Lower costs, Industry structure, Access to skills</td>
</tr>
<tr>
<td>DSGN₃</td>
<td>B2C</td>
<td>Quality, Industry structure, Mgmt interest, Contacts</td>
</tr>
<tr>
<td>OMC</td>
<td>B2C</td>
<td>Lower costs, Quality, Patent protection, Mgmt interest</td>
</tr>
<tr>
<td>OMB</td>
<td>B2B</td>
<td>Lower cost, Global pressure</td>
</tr>
<tr>
<td>STDB</td>
<td>B2B</td>
<td>Lower costs, Global pressure</td>
</tr>
<tr>
<td>FSTD</td>
<td>B2C</td>
<td>Lower cost, Mgmt interest</td>
</tr>
</tbody>
</table>

5.5.1 Cutting costs and lower prices

At first glance the cases above seem to confirm the results from previous research on motives for international sourcing. All in all the respondents were eager to talk about the low price of goods in China. The question is of course lower costs for what. OMB reluctantly admits that even before they start calculating the cost of production (including labour costs) they have already surpassed the price offered by the Chinese suppliers. If price per product is the main goal – the respondents in general find it hard to compete even when
sourcing small volumes. Many of the respondents also make the remark that in many cases the machinery holds more or less the same standard as in Sweden (see for example BTO1, DSGN1, OMc). Indeed the former Production Manager of DSGN1 admits that he was very impressed by the standard of the machinery when he visited the new Chinese supplier in southern China, and that it was then and there he realised that they had no alternative but to outsource the production.

Although the research on low cost country sourcing (c.f. Lockström, 2007) and consultant reports alike talk about low labour costs – this was not a particular issue that was discussed in the cases above. Indeed in most cases the buyer seems to look at the offer as a whole and not to each specific cost. In some cases (c.f. BTO1) the buyer leaves it up to the intermediary to do the negotiation and thus there is no real reason to look beyond the offer, indeed it might be hard in some cases to distinguish if the intermediary has added a percentage to the cost if the price is offered as a complete price. Low labour costs, although mentioned by the respondents, were not connected to motives for sourcing from China. Surprisingly, the price on raw material was mentioned (c.f. FSTD chapter 5.4.4) as being lower in China than in other countries. This was confirmed by other respondents in the study but only when the recording equipment was turned off. The topic is a sensitive one, especially since the European Union decided on their anti dumping measures on certain stainless steel components such as fasteners.

### 5.5.2 Other Strategic Motives

In figure 3.13 that summarize the motives for international sourcing five other motives are mentioned, one of which is global pressure, which will be discussed more in the next section. The other four, focus on core, market access, quality and skills and resources were mentioned in some of the cases above, though not as motives for sourcing from China. Most of the companies above are highly specialized as it is and were already, prior to the decision, focusing on their core. Although it might be said that the effect of the outsourcing decision of DSGN1 and OMb was that they became even more specialized (in the first case they focused even more on design and in the second case they focused on the high-end spectra of the products) this did not seem to be the main reason behind the actual decision.

Market access and quality was discussed by the respondents but not in relation to the decision to source from China. Some respondents admitted to have been sceptical towards quality of products in China (see for example OMb and STDb), thus presenting more of an obstacle towards the decision than a trigger. An interesting case when it comes to quality is that of OMc which found that the illegally produced copy had as good quality as that of the original produced in Sweden – only much cheaper. It might be argued that had they not found such good quality in China the decision had not been made at all.
Market access was not a motive for these companies either. In the case of OM\textsubscript{B} it was not access to the Chinese market that made them take the decision but the fear of losing a customer in Sweden that had a profound impact on the decision.

Finally – skills and resources – did influence the decision of the designer goods companies. Especially, the decision to choose China over other low cost countries in Asia or Eastern Europe seems to be affected by this. In this industry very little production is left in Europe and since most of the major competitors are choosing China as a sourcing market, this is where the competence is developing with the help of companies with resources. Indeed in the case of DSGN\textsubscript{1} the flexibility of the large supplier that they have found in China is beyond compare to what can be found in Europe. The supplier is able to house machinery for different techniques so that DSGN\textsubscript{1} is able to offer their customers a wide assortment of products all from the same supplier as opposed to letting many small specialized suppliers produce and even more importantly, are able to adjust their assortment to the trends in the market.

Another motive mentioned by Nassimbeni and Sartor (2006) and Eriksson (2008) related to China in particular is that of imposed sourcing, which is when due to governmental pressure, a company is forced to start sourcing in order to hold on to their investments in China. None of the companies in this study was directly affected by this. In the case of BTO\textsubscript{2} it might however be that part of the reason for the customer to put pressure on them was that the customer themselves were under pressure, but this could not be verified without interviews with the customer of course.

5.5.3 On Triggers and Motives

In the cases described above, although mentioning all the reasons that were summarized by the researchers in international sourcing presented in chapter 3.1.2, most of the companies elevates other issues to their decision. Above all there seems to be an eagerness to stress the external pressure that lay behind the actual decision, a need to justify their decision. There was nothing else to do. The decision was out of their hands. For the designer companies the decision was of course marked by the structure of the industry, for BTO\textsubscript{2} and OM\textsubscript{B} the decision was triggered by the action of a customer, which in a sense was the same for OM\textsubscript{C} and STD\textsubscript{B}. OM\textsubscript{C} realized that in order to be able to defend their patent they would have to narrow the gap between the original and the copies and in the case of STD\textsubscript{B} the customers were constantly asking them for an assortment of cheaper products. Thus it seems that although their decision might be explained by lowering costs the actual trigger that made them take the decision to act came from outside.

This is not of course true for all of the companies. In some companies management interest triggered the decision. The founders of BTO\textsubscript{1} had a dream of a manufacturer large enough to avoid too much of sending products
between suppliers, and after looking at alternative markets they finally chose China. For BTO3 the interest for China in combination with the contact with a Chinese businessman became the foundation of the whole Swedish company. Also in the case of OMC and DSGN1 the management interest was obvious.

5.5.4 An Extended Understanding of Antecedents

When listening to the respondents explaining why the companies choose to source from China, a clear difference between triggers (why the decision was taken in the first place) and the rationalizations (the reason why the decision to source from China was a good decision) seems to stand out (see figure 5.1). When discussing why the decision to source from China was taken, the companies seem to focus on external events, external pressure, and industry structure (the design companies). Management interest was not always a trigger, but something that was very evident in many of the cases. Indeed the former Sourcing Manager of STD8 admits that the CEO was more eager to start sourcing from China than he was; with the effect that the decision was prolonged for three years.

![Figure 5.1 Motives as triggers and rationalisations](image)

When the interviews took place the decision to source from China was of course already made and the companies had already begun sourcing from China. Alongside the eagerness to justify the decision there was an eagerness to justify the continued action of sourcing from China. The argument for this was the low price, the flexibility, the skills and the resources available in the Chinese factories (see figure 5.1). There were no indications that China was perceived as a costly or difficult country to do business with. Indeed BTO1 chose China
5 On why Swedish SMEs source from China

because they thought it was easy compared to India and the former Eastern European countries.

What is the effect of this? If low labour costs are not a trigger to the decision to outsource then there is no use in introducing a higher degree of automatisation as an alternative to outsourcing. The companies that elevated these triggers all felt that there were no alternatives. How will this feeling of not being able to avoid sourcing from China affect the upstream internationalization process of these companies? If China is perceived as a fairly easy country to source from is there a need for intermediaries or will the companies choose to source directly? This will be the focus of the next theme.
Theme
To the Middle
6 On how to source from China

The first theme argues that the motives of Swedish SMEs might be divided into triggers and rationalizations. The triggers were in the cases above connected to external events or the specific interest of management. The rationalizations however confirmed the findings of previous researchers that costs, flexibility, search for specific skills or resources were important. This chapter discusses at the other side to the research on international sourcing, that of the process models and typologies.

6.1 How do Swedish SMEs source from China?

The second theme that has greatly influenced international sourcing is the internationalization process and the choice of mode in the new markets (see figure 6.1). The basic assumptions presented in the process models are that companies choose intermediaries in the early stages of the venture, especially if international experience per se and resources are limited. Process models then argue that as time pass the companies will move beyond the intermediary to invest directly or source directly, whereas typology research is not as deterministic and argues that using intermediaries might be a long-term strategic choice.

Figure 6.1 International sourcing on intermediaries (see chapter 3)
Apart from being a mode, it was also argued that intermediaries could be used as a node – a point of entrance into a new network in a new market, long-term or short-term, a theory that is supported by the typology presented by Nassimbeni and Sartor (2006) as especially suitable for China. Finally, the international new venture and born global researchers claim that today, considering the widespread ability to speak English and the infrastructural advances, there is no need for intermediaries at all – not even in the beginning of a venture.

Looking beyond research within international sourcing, intermediaries could fulfil a number of functions. Transaction cost theory suggests that intermediaries may lower costs for searching, negotiation and monitoring while value chain analysis suggests assortment and accessibility to the search functions. Within supply chain management these functions come down to six activities – production, logistics, financial, knowledge, indirect and administrative. In this theme the empirical data concerning the mode selection is presented from the perspective of the Swedish SMEs. This will also be related to the functions that the intermediary has in the cases where intermediaries are used for sourcing.

6.2 Build-to-order goods for the Business Customer

Again, the first category of companies presented is the companies that source built-to-order goods for business customers. The challenge that these companies face is keeping an open communication between the Swedish customer and the Chinese supplier. Each order creates a new challenge and a new order purchase (see chapter 2) which means that, as opposed to the fairly regular orders that the companies that provide standard goods may offer their suppliers, dealing with BTO goods means that you never know what type of product will come next or how often you will be in need of a certain competence. This is especially true for BTO1 and BTO3.

6.2.1 When you’ve tried it all – BTO1

As described in chapter 5.2.1, the Founder of BTO1 dreamed about being able to offer its customers complex components consisting of many different production steps. This dream was pursued first in Poland, the Baltic States and India, without success. When the decision finally landed on China in the late 90s, a Hong Kong based intermediary seemed to be the best solution for sourcing from China. The main reasons for using an intermediary according to the Founder of BTO1 were the inadequate infrastructure in China (no fax or
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email) but above all the lack of English skills among the Chinese that they had met. In Hong Kong they found intermediaries with good English skills and vast knowledge of western business culture, while at the same time well connected to the manufacturers on the mainland.

Throughout the years BTO1 had dealt with many different types of components, using many different materials and many different methods of production. This made them demand a supplier base that was able to respond to this need for flexibility and, in some cases, even interaction between independent suppliers. Building relationships with suppliers under these circumstances is not effortless. The company had a policy to make sure that the same component always was produced at the same manufacturer to maintain a consistent quality, when a new order on a previous product came in. At the same time, when the component was no longer in production, the relationship became latent, a manufacturer on a list of other manufacturers to whom inquiries were on a regular basis sent out. Although the main strategy is to keep a steady set of suppliers with whom one was able to build long-term relationships, the demands of the customer forced the company to constantly keep an eye open for new suppliers to satisfy the need for new solutions. This meant that finding and evaluating new suppliers was a constant process aside maintaining existing relationships. It also meant building relationships without a constant flow of orders.

In addition, the constant search for solutions to new components meant that there was a steady flow of inquiries to handle, often with rather low return for the suppliers. Considering the business climate at the time when the interviews were made, the CEO estimated that about 20 per cent of the inquiries that they send out to their suppliers actually lead to business, then for the supplier the number are even lower due to the competition among the suppliers. The relationship went on as long as the component in question was in production, after that there was no way of knowing when or if there would be another deal. With the heavy focus on finding new suppliers to fulfil new needs, BTO1 had of course used multiple ways to find and evaluate suppliers.

All in all the Founder of BTO1 estimated that they had approximately 15 suppliers with whom they place orders on a regular basis. Six of these were Taiwanese companies although the CEO feels rather confident that much of the products that these companies produce were actually made in Mainland China. Some of the companies were dealt with through traders. In fact, the founder states that sometimes it might be hard to know if the person that they talk to really is a sales representative of the manufacturer or a trader.

As mentioned, the first contact was a traditional intermediary, situated in Hong Kong, which contacted the Founder upon as a response to an Internet ad sent in by BTO1. The intermediary worked completely independently. It found and evaluated the suppliers and although BTO1 was welcome to visit the companies while in China, all contacts were handled through the Hong Kong intermediary. The suppliers are all Mainland Chinese. The same goes for the
Shanghai intermediary that was introduced to BTO1 through a former employee at BTO1. This intermediary also found and evaluated all suppliers and managed all contacts. The price for the services that these two intermediaries supply was encompassed in the final invoice. A third intermediary, situated in the southern part of Mainland China, was used for a period of time. This was an old contact of the current CEO. The intermediary was founded and managed by a Westerner who had moved to China, and who worked under the same condition as the above. This contact was however rather quickly brought to an end, according to the CEO due to the sporadic flow of inquiries and the low frequency of inquiries led to orders.

The situation with BTO1’s Taiwanese intermediary was different. Here there was a continuous agreement, with a set sum of money that was paid every month for the services and then an additional commission. The suppliers that were handled by the Taiwanese intermediary were a mixture of Taiwanese and Chinese suppliers. Although the initial contact was sometimes made by the Taiwanese intermediary, most often the initial contact was made by BTO1, who then asked the intermediary to visit the supplier. At the time of the last interview they were planning to set up an intermediary in China, co-owned by the Taiwanese intermediary and BTO1.

Apart from using the Internet, visiting trade fairs and occasionally answering unsolicited proposals that arrive in the mailbox, BTO1 has tested many different ways of finding suppliers. Two of their efforts were especially interesting since I had not encountered them at any other cases, one was when BTO1 decided to use the back-door contacting the suppliers of raw material and one was when they used an intermediary in Sweden.

In the beginning of the 1990s, the Founder of BTO1 was looking for manufacturers of sintered goods in China. For sintered goods the raw material is essential for the outcome of the quality and at the time they found it hard to find a good supplier in Taiwan. Finally, the Founder decided to go the other way. He arranged a meeting with a large, Swedish supplier of high quality sinter situated in Taipei, Taiwan. The producer of sinter provided BTO1 with a list of all manufacturers using their sinter for production, i.e. their customers. From this list BTO1 picked a number of suppliers which they visited and then eventually began to cooperate with. One of these suppliers was still considered to be one of their more trusted suppliers. As the Taiwanese suppliers were now moving their production to Mainland China, BTO1 continued to buy through the Taiwanese headquarter.

Despite their own experience of sourcing from China the constant demand for new suppliers did put a strain on the company resources. At a trade fair in Sweden they met a woman of Chinese origin with a trading company focusing on helping small Swedish companies sourcing from China. On a one-year contract with a fixed monthly pay corresponding to one day work per week, the intermediary was assigned to find and evaluate suppliers in China. This cooperation was terminated after a year. Though very satisfied with the
suppliers that the intermediary in Sweden had found for them, BTO₁ found that they were not able to handle the amount of suppliers that the intermediary provided them with especially since the intermediary was not qualified to do the final inspection to make an assessment of the machinery and product quality.

Finding suppliers is of course only one aspect of the process. Evaluation of the suppliers means presence. BTO₁ uses the same criteria as most other companies, looking at certification; preferably suppliers from automobile companies, good and modern production facilities, machinery etc. The CEO however points out that these criteria are not sufficient as tools for assessments. They may not even be adequate. A company may display all the requirements with the newest machinery available, but not the skills to handle it. And the opposite. Indeed, the CEO and the Founder agree that judging by the messy look of the facilities of one of their most trusted suppliers that they have done business with for many years; it is hard to believe the quality of the goods produced in the factory.

### 6.2.2 The Giant Leap – BTO₂

In the case of BTO₂ (see chapter 5.2.2) the decision to approach the Chinese market was the direct consequence of the need (or demand) from one of their major customers. Once the decision was taken there were no strategic alternatives since the only way in which they could solve the deal and still keep their customer was to start up production of their own in China.

The process went quickly and smoothly. The initial discussion with the customer was in September 2004 and production in the new-built factory started in December 2005 – 15 months later. They started off by asking around, listening to the stories of other companies that had already moved production to China. A list of contacts from the Chamber of Commerce also provided a great help in this search. The main lesson from this initial information search was that a lot of the companies, especially those that held on to development and construction in Sweden, faced major problems with above all quality and logistics.

The second step was to decide on location. Travels to China, especially Shanghai which had been promoted by the Swedish companies with whom they had had contact, was made in order to have a look at different industrial parks but there were so many and the size of the industrial parks intimidating. The CEO in Sweden concluded that when in China, they felt really small in comparison to the manufacturers they visited.

The process was facilitated by finding a key person – a Swede who had previously worked in China and who was willing to go back and be in charge of setting up the factory. The decision on location thus boiled down to the experience of this person and his contacts in China. His first decision was to employ an old friend, a Chinese woman with whom he had worked with before and who became his right hand and assistant. She had all the contacts needed...
and, using the words of the CEO of Sweden, is also their primary “language and culture interpreter”. The start up process provided a number of surprises, in which the Chinese assistant was indispensable. At the employment agency they had to set up a stand on their own with a list of what type of employees they needed in the factory and then perform the interview while those who were interested stood lined up in front of the stall. Not to mention the surprise when the Swedish CEO realized that renting empty facilities in an industrial park meant really empty, no electrical sockets, no water taps. The Chinese assistant however took this for granted. Of course there would be no electricity or water, this must be installed after the layout of the factory was completed so that they would be placed correctly.

In order to ascertain the same quality on products produced in the Chinese factory as those produced in the Swedish factory, much emphasis was put on buying high quality plastics, good tooling and by making sure that personnel from Sweden were involved in the Chinese factory. The German factory that provided the raw material for the Swedish factory also had a subsidiary in nearby the Chinese factory which made things easier. The machines were another question. The intent from the start was to use European machines, the same brand as they used for the Swedish factory. In the end however, they decided to buy Chinese machines. The main reason was availability of maintenance and service would be hard if machines were bought in Europe and then exported to China. The trigger for the decision however was a meeting with the representatives of the Chinese machines that had their head office close to the head office of BTO which offered a security in that they now had a Swedish contact with whom they could discuss should things go wrong in China.

Despite setting up a team in China, the set up period involved travels for the personnel. Apart from the CEO and the owner/sales manager, technical personnel from the Swedish factory were sent down to assist the start up of the machines in China. Although the CEO in Sweden felt sure that the Chinese personnel would have made it on their own, they felt it was better to be safe than sorry, especially considering the tight schedule. The machines were installed in the beginning of December and the first batch was promised by the first of January.

Setting up a new factory on the other side of the world is of course not cheap. That product, the first product to be produced in the new factory, for the customer who introduced the idea, was, as mentioned before, very costly to transport and import to China. Much of the costs involved in setting up the new factory were thus “paid” for by the surplus from keeping the price agreed upon with customer despite the lower costs of transportation and import. Long-term however it is important that the Chinese factory bears its own costs. The purpose was not to move production from the factory in Sweden to the factory in China but to let the Chinese factory serve the Chinese market while the Swedish factory served the rest of the world. Thus the second stage became
to build up a sales department in China that could approach the Swedish and European customers with production in China to offer them high quality components. In the beginning, this could be managed from Sweden so that the deals were negotiated and closed in Sweden/Europe but manufactured and transferred from BTO2’s factory in China to the customers factory in China. This provided a clear advantage: the components that the customer wanted for their European factories were transported and cleared within the European Union and the components for the factories in China were transported and cleared within China which meant no export or import charges.

Soon, however they realized that in order to wholly explore the 14000 m² factory floor that they rented in the industrial park in China, which was the smallest available, they had to supplement the factory with a sales department. Taking advice from companies with longer experience they decided that there was a need for a Swedish CEO for the Chinese factory with focus on sales. Contacts with experienced of subsidiaries in China, suggested that managers in charge of both sales and sourcing would most likely favour one or the other.

Separating sourcing/production and sales between two Swedish managers (the one in charge of the start up became Production Manager whereas the Sales Manager became the CEO of the Chinese factory). This enables the managers to focus on their specialty. At the time of the final interview BTO2 was still not really exporting any goods from the Chinese factory to the Swedish factory except for the surplus from their production. The Sourcing/Production Manager and CEO of the Chinese factory were however hoping that in time this might be possible – not of course as an exchange for the products produced in Sweden but as a supplement to the existing assortment or in case of a surplus in the Chinese production.

6.2.3 The Integrated Supply Chain – BTO3

The founders of BTO3 met when they worked at the purchasing department at a medium sized company, with vast international experience. In 2005 the two Swedish businessmen had decided to leave their current position to try something new and decided to renew the contact with a Chinese businessman whom they had met at a trade fair in Germany. A couple of years earlier, this Chinese contact had decided to start up on his own, with a factory in the northeast of China, producing mainly metal components and an assortment of metal products.

As described in chapter 5.2.3, BTO3 and the Chinese contact established an integrated way of working that involved the whole process from inquiry to finished product. The BTO3 approached the Swedish customers, offered them an overnight 3D cad blue print of the product that they only had a drawing of. Taking full advantage of the time difference, the drawings were sent to the Chinese factory that provided a blue print by the time sun dawns in Sweden, including suggestions as to what changes may be made in order to lower costs.
Then the two Founders of BTO\textsubscript{3} went back to the customer to try to sell the suggestion.

In just five years BTO\textsubscript{3} reached a turnover of 37 million SEK. They have expanded their base of suppliers to three suppliers that manufactured supplementary product and were located fairly close to each other in China. All three contacts are described in detail by the two founders in Sweden, they were found and contacted by BTO\textsubscript{3}, but the roles in between the suppliers and BTO\textsubscript{3} seemed to follow a relaxed path. All three suppliers in China were in contact with each other and did business together on multiple levels. In showing their catalogue, some of the products that had been sold by BTO\textsubscript{3} were clearly not within the core business idea of complex metal components, but clearly within the category of goods that could be labelled what-the Swedish-customer-wants-and-the-Chinese-suppliers-are-able-to-supply. There is no real turnover of suppliers; they were more or less set. Adding a supplier in China would mean involving the existing suppliers in order to make sure that cooperation remains.

6.3 Designer Goods for the Consumer Market

As seen in chapter 5.1.2, there were few alternatives for the companies with designer goods but to source from outside Sweden. Indeed, to some the choices were even more limited due to the fabrics they use. Just as the BTO companies above, the three designer goods companies described below have chosen different paths for their sourcing venture.

6.3.1 On the Fast Track to Change – DSGN\textsubscript{1}

Sometimes there is no the time to take it slow. For DSGN\textsubscript{1}, the time from the outsourcing decision to receiving the first batch was less than six months, a process that today is spread over a year. Although the discussion had been going on for quite some time between the board and the CEO, it had never left the board room. Thus the actual decision came suddenly for the employees. The new Production Manager was just about to start, but was asked to start a week later to let the initial reactions settle. From day one, his mission became to find a suitable supplier in the southern part of China and to make sure that the products arrived on time and kept the high quality that was the company’s trade mark. The Former Production Manager, who had worked more or less his whole life in the company, who was the first employee ever hired by the Founder, who had witnessed the transformation of the company from a one man basement company to a full factory was left with the ungrateful task of
downsizing the number of employees in Sweden. Many of these employees had worked for ten or twenty years together with the Former Production Manager and his wife. The opposition was strong and the Former CEO, that took an active part in the decision, felt as if he was letting his employees down. On the other hand he felt, that the decision was inevitable and to drag the process out would only hurt the company in the long run. The Former Production Manager accompanied the new Production Manager on one of the trips to China and was reluctantly impressed with the production plants and the machinery it was much more modern than he had expected.

The first trip to China in order to find suppliers took place within a month of the decision. They started to look at 6 suppliers. The list quickly boiled down to one supplier, partly based on recommendations from people in the same industry and partly because the supplier was also producing similar products from high European brands. Despite warnings from others in the business the CEO that took over during the start up process was reluctant to spread risks by using multiple factories. Instead of constantly pushing for lower prices he felt that it was necessary to develop a good relationship with one supplier in order to secure quality and delivery times.

I have never heard about anyone building many factories in order to reduce risk. You will have to be grateful if you can find one [supplier] that is good and besides – it will cost you. Both in terms of money and in terms of time of handling a process like that //So we don’t discuss if it was the absolutely best manufacturer that we could get. We build our relationship on that manufacturer and I believe that it has been a key factor to our success.

(CEO of DSGN1)

As the decision regarding a supplier was starting to settle, there came a realization that the routines that had been developed over fifty years were no longer adequate to handle the new situation. Despite the fact that they had outsourced parts of their production to an Italian company for many years, this process had been very different. In the Italian case, the whole process, including the design was outsourced so that in reality they were buying the whole product. In the China case, there would be no outsourcing of design. They had to start from scratch, to analyze every step in the cycle and to push the designers to let go of their design in order to send them to production. In the past, the distance between design and production had been no more than a step away.

The company was not prepared for outsourcing. All production knowledge was enclosed within the factory walls. You went down and produced you ideas basically from our mind. There were no blueprints at all. So that really messed things up. We had to start from scratch. Draw up the design. Learn how to draw. Get the software to support it.

(Former CEO of DSGN1)
This meant that the designer could more or less have a prototype done in an instant, and if it was good, and it was just a matter of priority when it was produced. The lead times calculated were four weeks. Now the process had to be extended to one year. The company was not fully prepared for the change, and the start up was tough. Finally, an external consultant was contacted to help them prepare for blueprints and to find processes that could be coordinated.

During these first critical months, the Production Manager travelled back and forth between China and Sweden once every month, mostly accompanied by the CEO. Despite the fierce pressure, they managed and within six months the products were in the stores. Before the end of the year they managed to break even but it took another year before the processes started to settle.

The outcome of the experience along with the realization that one of the major competitors had ownership interests in the main manufacturer led to the decision to take on another supplier in China. While the main supplier in China, which produces about 50 per cent of the total product line, has remained the same from the start, the second supplier, responsible for about 10 per cent of the production, has been changed a couple of times. The remaining 40 per cent comes from the Italian supplier.

6.3.2 The Art of Avoiding Others – DSGN₃

DSGN₃ was a textile company that produced functional clothing of high quality and has always bought their apparel lines from China. The current Owner bought the brand from a large textile company in 1998, and the present company is built around the original idea of functional clothing for men, women and children.

DSGN₃ searched for and worked directly with the manufacturers. The suppliers were found mainly through recommendations, indeed all the suppliers used at the time of the interview were found through recommendations. The recommendations from new employees in Sweden were especially important. The attitude towards trade fairs and online directories was sceptical. The CEO of DSGN₃ found the outcome too low, out of ten factories met at a trade fair you should be lucky if one is good enough to try for a sample. The exhibitors’ promises of quality and price are rarely fulfilled once you visit the factory.

Still there were some mixed feelings in regards to the use of the same suppliers as those of their competitors. The CEO of DSGN₃ stated that they try to stay away from suppliers that produce for other Swedish companies. He felt that there was too much copying going on and by avoiding sharing suppliers with competitors the company avoids some of the risks.

DSGN₃ were currently sourcing from about 13 suppliers, all in China. Most of the orders were placed with three or four suppliers that were considered main suppliers. Two of these had been suppliers from the first order in 1999. The relationship with these was considered very important. DSGN₃ considered
it to have been an advantage to have found companies that they have been able to grow along side with. Above all it has made it easier to place smaller orders. On the other hand, close relationships made it harder to press down prices. DSGN3 have found that pressing the price could in many ways be detrimental to the relationship as well as the quality. Even they were able to shake that price down to the bottom, this would only be at their disadvantage when you come back six months later. The alternative would be a constant search for new suppliers which is costly, especially when you are dependent on good quality.

A higher price was thus accepted in favour of a lasting relationship which was one of the reasons why the list of suppliers had been fairly constant throughout the years. The remaining nine suppliers were brought in for specific competences; they each had their speciality such as knitted garments, accessories, caps or a special vintage look that might be in fashion. There was also the question of quality. High quality garment orders were placed with certain suppliers and the medium quality garment orders are placed with other suppliers. Assessing new suppliers was considered difficult. Although the possible suppliers were able to display new and extremely expensive machinery they were not always able to handle them. This meant that presence at the factory was extremely important to DSGN3. To go through the factory, making sure that there were adequate machinery for the intended production, that there were enough number of machinery, that the overall conditions were good, neat and orderly, the personnel, working hours etc. The management team is was also an issue to add to the list. There seemed to be no preferred type of organisation, DSGN3 had chosen to work with suppliers that are cooperative as well as privately owned.

It is important to quickly learn who are in authority. Otherwise the discussions will lead nowhere

(CEO of DSGN3)

To start up a factory of their own was not considered to be a viable solution. This would severely diminish the flexibility of the production. In order to stay in fashion and to be able to try new materials, new suppliers were added. The main reasons for terminating a relationship with a supplier were inadequate quality or financial problems. In the end the number of suppliers became an act of balance. On the one hand finding flexibility in production and on the other hand limiting the number of suppliers in order to maintain good relationship with these.

In regards to the size of the supplier, DSGN3 used both small and large suppliers. One of the main suppliers had no more than 200 employees which by Chinese standards are rather small. The other main suppliers had somewhere between 700 and 1200 employees which made them medium sized. It is of course easier to become a large customer to the small suppliers but the intent is not let the suppliers become to dependent on DSGN3. The clothes were very seasonal and thus it was important for the suppliers to find other customers to
serve during low seasons. This was yet another reason why having a factory of their own is out of the question. The CEO of DSGN3 estimated that they filled approximately 75 per cent of their supplier’s production, while the equivalent number for the second largest supplier was 50 per cent. These were however the only two for whom DSGN3 were such a large customer. Most of the suppliers had export licences, so there was no need for an intermediary to handle the payments.

At times, especially when they were faced with an especially important order they sometimes resigned to use quality controllers in order to make sure that the quality was right before the order leaves China. Some of the garments that were produced by DSGN3, such as for example a children’s raincoat, would not amount to any high value orders even if the order was large in number of garments. A performance wear jacket for adults on the other hand might cost as much as 4000 SEK, and then high sums are reached soon. The quality control companies are usually employed per order and then replaced quite easily.

6.3.3 Sticking to the Network – DSGN4

As suggested in the first theme (chapter 5), in some industries there is so little manufacturing left in Sweden, that the companies are more or less forced to become international from day one. The Founders of DSGN4 had a long background within the textile industry before they started up the company. Indeed the company was run more or less as a hobby for the two Founders, and in the beginning they focused on producing highly specialized clothes for extreme sports in very small collections. The small quantities were mainly produced in the nearby area, with the exception of GORE-TEX garments. The companies with a license to design and sell GORE-TEX clothes are not free to choose just any manufacturer they want. Both the company who owns the design and the manufacturers need a license from GORE-TEX, which means that there is a limited list of manufacturers that you could possibly use. On the other hand GORE-TEX quality controls and test not only the fabrics but also makes random checks on the quality of the production themselves which facilitates the process.

Thus the materials in use restrict what manufacturers may be used. When quantities were small, manufacturing of GORE-TEX material was placed in Portugal but as the collections became larger it moved to China. So did the rest of the DSGN4 collections. When first finding factories for the non-GORE production line, the founders started off by building on existing relationships. They started by contacting a man with whom one of the founders had had contact with during his previous employment for a larger clothing company in Sweden which produces most of their clothes in China. One of these contacts, a man from Korea, decided to start a factory of his own. Thus a special business relationship had formed between DSGN4 and the Korean
manufacturer since DSGN\textsubscript{4} was there with their orders and their knowledge and contacts when the Korean manufacturer had no customers. At the same time the Korean manufacturer were flexible enough to take on even the small orders. This meant that DSGN\textsubscript{4} was able to get a foot in the door of the Chinese market despite their small quantities and also avoid the initial costs of finding and visiting many suppliers. At the time of the interview the Korean manufacturer owned a number of factories at different locations in China; the main factory had approximately 2000 employees, according to the Swedish Purchasing manager at DSGN\textsubscript{4}. Approximately 60 per cent of the total turnover for DSGN\textsubscript{4} came from production in these factories.

Apart from this main supplier, DSGN\textsubscript{4} was using around 8-10 suppliers all in all, depending on season. Most of them were small to medium sized companies, with a head office in Hong Kong through which the contact were made, partly due to the limited English skills in the factories. According to DSGN\textsubscript{4} large manufacturers demand large volume orders, which DSGN\textsubscript{4} was not able to provide. The trick was to find medium sized manufacturers that were able to supply good quality products in small volumes. The strategy was to work with the supplier’s long-term and as closely as possible. The type of functional clothing that DSGN\textsubscript{4} produce was not so price sensitive which is why a constant search for lower price in the long run would not pay off.

The strategy of keeping few relatively small suppliers was also related to the size of the collections. On the one side – when you have a small collection of one model you might bundle a couple of different garments using the same fabrics in order to work around the problem with mini orders on fabrics. On the other hand, when at times they did get a larger order on one garment, it might be that the suppliers were too small to be able to handle the whole order. Then DSGN\textsubscript{4} had to spread orders using many suppliers for the same collection. All in all, there was a need to look at the whole collection before they decide where to produce what. The worst-case scenario means that they had to pay a certain extra fee for the small volumes.

Changes in the number of suppliers did occur, and the Purchasing Manger estimates that once every third year or so a new supplier is added. The main reason for adding suppliers was that as the collections had grown throughout the years and were still growing, which means that more suppliers were added to supplement the existing list of suppliers. When new suppliers were needed DSGN\textsubscript{4} preferred to listen to recommendations from others, colleagues in the industry, competitors or new employees bringing their experiences from previous employments. To go out and find suppliers without a previous recommendation was considered too costly, there were too many to choose between. When meeting the new supplier DSGN\textsubscript{4} asked for more references, and if the references were of companies that were considered to have high quality collections, they might try them out. Competitive brands were in this way used as an indication as to the proficiency of the manufacturer. Although the Production manager of DSGN\textsubscript{4} stressed that the method was not foolproof
there were of course no guarantees that just because they used the reference that they were up to standards, but it was one important way of making a first cut from a potentially very long list of possible suppliers. When visiting the new supplier, apart from the compulsory list of making sure that the quality control systems were up to date, that the production facilities were clean and orderly, the purchasing manager also stressed the importance to look beyond the checklist to get a feel for the supplier, and the sales representative that were to be the main contact when they have returned to Sweden. With geographical distance it was important that that communication worked out.

6.4 Standardized Goods

The companies above had products that were either produced in rather small volumes and for one season but then replaced by other designs, or products with limited life cycles that sometimes span over longer periods, but which were eventually replaced and then not necessarily with products produced with the same supplier. This section contains the stories of the companies that provide products with longer life cycles, thus the need for flexibility or multiple production methods is not as big, which affects their strategies in China.

6.4.1 On How to Copy a Copy – OMc

As mentioned in chapter 5.4.1, the reason for OMc to move production to China was the rising cost of fighting intellectual property intruders, especially when their own production costs left little surplus to cover these costs. While on a trip to China to confront some of the manufacturers responsible for copies, they decided to take a closer look at the facilities and the products of some of these manufacturers. They realized that one of the copies was just as good, if not better, than the original despite the lower costs of production. The decision was quick, and the production was already on so there were no initial set up costs and no extended set up time for testing new processes. Within a couple of months from the decision the first containers started to arrive.

6.4.2 To Overcome the Odds – OMb

As presented in chapter 5.4.2, OMB started to source from China when they found out that their largest customer had decided to source the products they sourced from OMb from China instead. As described in chapter 5.2.3.1 they started in 2001, buying components through a Hong Kong intermediary with previous experience from helping Swedish companies. They quickly realized that this solution would not be enough. Firstly the quality of the products bought through the intermediary was not good enough.
6 On how to source from China

Though the product is quite simple there is still a craftsman’s knowledge from 50 years of production in Sweden that we need to transfer here.

(CEO of IPO in China)

Apart from the transfer of production knowledge they also realized that buying small volumes from many different suppliers meant higher costs for transportation. They needed a place for bundling. Located in an industrial park in the vicinity of Shanghai, OM8 opened a purchasing office in order to test quality and to bundle orders for transportation to Sweden. The office had Chinese employees only, but for the CEO of the IPO. At the time of the interview the CEO was a Swede who lived in Sweden and travelled back and forth between China and Sweden. In order to support the IPO other employees from the head office were taking turns to visit China.

Most of the suppliers were from the Shanghai area. The Supply Manager at the subsidiary made continuous visits at the suppliers, but the longer they had worked together the fewer the visits. The Hong Kong supplier, with whom they have had contact since early 2001, sometimes visited the subsidiary instead of the opposite. The CEO of the Chinese IPO stated that there was a clear difference between handling the relationships with Swedish suppliers and those in China. In China he felt that it was important to pay regular visits in order to show that you exist and that they were important.

6.4.3 On a Slow Boat to China – STD\textsubscript{B}

As mentioned in chapter 5.4.3 STD\textsubscript{B} had some initial hesitation towards sourcing from China. Despite the support from the CEO, it was decided to develop the relationship with the European suppliers first. The uncertainty concerning quality, delivery times and storage turnover made higher prices worth the while. When the decision was finally taken, STD\textsubscript{B} started off looking for suppliers together with some German colleagues. The collaboration started with buying from a Taiwanese supplier who had decided to set up manufacturing on Mainland China. The next step was to go beyond the Taiwanese company to look for suppliers of their own by using intermediaries.

In this way they managed to increase order volume, thus making the inquiries more interesting for the Chinese manufacturers as well as spreading the risk of the venture as a whole. This was perceived as necessary. Despite using mainly large suppliers they soon realized that quality and delivery times presented potential hazards.

The cooperation with the Germans soon came to an end however. Their objectives turned out to be very different. Whereas the quality was the main priority for the Swedish company, price was the main objective of the German company. In China these goals were not always compatible. The problems with quality and on time delivery were hard enough to negotiate with the Chinese.
If they [the Chinese suppliers] received the confirmation that a batch that was expected in week 10, that it was ok to receive the batch in week 20. Then they [the Chinese suppliers] felt that it was no late delivery, but we had still expected the goods in week 10 and the same thing about quality. If the screw fit the nut then there was no problem, but the thing was that this screw might be intended for a completely different application than the one they were thinking of. It just didn’t work out //it was not only a matter of just using the right packaging but to pack suitable for export

(Former Purchasing Manager at STD_B)

After the German cooperation STD_B they continued to take one step at the time in their sourcing process. In the beginning they turned to foreign owned manufacturers. One of these was a very large Indian manufacturer in the automobile industry that had set up a complete factory in China, using Indian production personnel. The Indian company had been pushed into China by their customers who, in turn, had set up factories on their own in China and now demanded products to be produced on site. In the process the Indian company was left with an overcapacity that worked in favour of STD_B. This experience also set the direction for evaluating new suppliers. By following the steps of the automobile industry the right level of quality and service was maintained at a reasonable cost. Meanwhile the costs of training and development were pushed to larger buyers from America and Germany. All in all, a lot of emphasis was put on finding suppliers with the “right way of thinking”, sometimes in the interview referred to as “a European way of thinking”.

Thus the process followed a rather straight line. First through the external German partner, then through intermediaries, surpassing intermediaries working directly with suppliers; primarily foreign owned manufacturers established in China, then through Chinese companies. Each step took approximately 18 months.

STD_B had two categories of products, the main part consists of standardized products bought en masse, stored in Sweden and then transported to industrial customers. The second category of products is BTO goods, usually a demand from larger customers that are already using STD_B for third party logistics and supply of standardized goods. The transformation from manufacturing company to a trader offered what the Purchasing Manager called “an overall solution” and started in the beginning of 1980s. All production was outsourced and machinery for production was replaced by storage and testing equipment. Meanwhile the organization had grown internationally. Purchasing offices had been accompanied by sales offices. One reason for the international expansion was to follow the customers. It was much easier to get hold of larger deals and contracts if you yourself acted internationally and was able to supply and service the customer in all markets.

Once a year the company made an audit of all product categories and all suppliers. Based on this audit the Purchasing Manager made a decision
regarding the need for new suppliers, but the search for new suppliers was a continuous process handled by the purchasing office of the country in question.

The yearly audit was based on the information retrieved from a database of information regarding the suppliers. It was updated both by the purchasing managers and the personnel at the headquarter that received the incoming goods. A wide range of information could be found in these archives. Quality, on time delivery, environment and working conditions were the parameters that the Purchasing Manager at the head office stressed. All factors that were registered in the database were given points that reflected their level at a particular factor, and each factor was then weighed so that some factors became more important than others. Soft values are also represented, though not as stressed as the rest. The present Purchasing Manager mentioned relationships and flexibility as part of the intangibles.

This was the assessment of the current purchasing manager at the company’s headquarter. The assessment of the former purchasing manager that was no longer employed in the company was somewhat more ambivalent towards the data based system. To him, the system was a hindrance to building relationships. If the points received by the supplier fell under a certain number, the purchasing managers were no longer able to send off an order to that supplier. This left the purchasing manager with the choice to either very quickly come up with an alternative supplier or find a way to quickly boost the point of the existing supplier. The system seemed to encourage the employees to manipulate the figures to suit their own interests. The former purchasing manager also felt that the soft values were far too underestimated in general. It came with the industry. There were so many customers and the competition was fierce. The suppliers were looking for the larger orders and small inquiries were not prioritized.

6.5 On internationalization processes and Intermediaries

How did the Swedish SMEs in this study prepare for their sourcing venture? Looking at how the respondents describe the period directly after the decision there seems to be no paved road to success. The fact that there are so many companies, of all sizes, that are sourcing from China makes it far easier today to tune in on industry intelligence than twenty years ago. The research made by Nassimbeni and Sartor (2006) suggests that intermediated sourcing is the most appropriate strategy for small companies, especially if the volumes are low. The companies in this study, however, seem to suggest the opposite – at least when you listen to the descriptions of how the companies plan the start up process and how they find and evaluate their suppliers.
Instead of showing some consistency in their approach to sourcing from China the Swedish SMEs presented above display a wide array of strategies (see table 6.1). Some start up slowly, collaborating with horizontal actors, building up knowledge, using intermediaries and then investing in IPOs (c.f. STDB). Others move quickly and manage to go from zero to full production within months (c.f. BTO2). It is interesting to note that with the clear exception of STDB there are few processes going on that might be explained by the time factor. China

Table 6.1 Overview of sourcing mode and type of intermediary used (Intermediary (Int.), Wholly Foreign Owned Enterprise (WFOE), Direct sourcing (Direct), Trader (T), Agent (A), Import Broker (IB) Quality Centre (QC), International Purchasing Office (IPO) Internal (I) or External (X); Hong Kong (HK), Taiwan (TW), Shanghai (SH), Sweden (SW), Shanghai extended area (SHX); Long-Term (LT) or Short-Term (ST); Hidden (H), Commissioned (C), Percentage (P) or Internal (It))

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has, only been open to trade for less than 35 years, after all. With the exception of BTO1 that started in 1989, most of the other companies did not approach China until the late 1990s and the early 2000s. All companies except BTO3, DSGN4, and OM3 had some sort of presence in China. The main reason why these companies had refrained from using intermediaries was mainly due to the relationship with the supplier. In the case of OM3 the supplier was found under very special circumstances. Despite this there was a discussion between the CEO and the Production Manager about whether or not to have somebody on location in China. The CEO maintained that no intermediary was needed. BTO3 and DSGN4 also met their suppliers under special circumstances where a business relationship survived through a down period when both sides (the Chinese supplier and the Swedish buyer) started up new companies.

As for the rest of the companies, all have decided to have some sort of presence in China, whether it is temporary quality controllers (i.e. a quality controller used for a specific order that is sometimes replaced and sometimes reused for another order) or a subsidiary. The following discussion looks at some specific issues in relation to the use of intermediaries based on the theoretical discussion in chapter 3.

6.5.1 The Clandestine Intermediaries

The one company that did use intermediaries in the start up and from time to time to look for more suppliers (see chapter 6.2.1) did not consider intermediate sourcing as a strategic option, rather one of many ways in search for the perfect combination of low price and high quality. In the discussion with BTO1, three different types of intermediaries emerge. First, “the traditional” intermediaries, those are the ones that create a link between the Swedish buyer and multiple Chinese suppliers. These are the intermediaries represented in table 6.1. These intermediaries may in turn be divided into three categories based on the framework by Burt et al. (2003), the traders that manage an exclusive or at least partially exclusive supply chain, the import broker with an open supply chain and the intermediary that works in close collaboration with the Swedish buyer, though according to BTO1 all are commissioned by them, i.e. the buyer.

The exclusivity of the supply chain does not seem to bother BTO1, not as long as everything is working well. When delivery times from the suppliers, handled by the Hong Kong intermediary, began to falter, BTO1 suddenly found them in a position where they found it hard to handle the problems. The lack of transparency left them unsure as to whether it was the intermediary or the suppliers that was the cause of the problem. Long-term relationships die hard, and this trader helped when no other door seemed available to the Chinese market. The Taiwanese trader also represented a special case since despite the lack of technical competence; it remained valuable in the sense that it had the language skills, the time zone and physical proximity to the suppliers.
The second category of intermediaries that BTO1 refers to is the clandestine intermediaries that represent one supplier only and whom they encounter when they themselves look for new suppliers directly. These could be companies in possession of an export license needed by the supplier in order to export or just a skilled salesman. To BTO1 these are like any other contact person and they did not really dwell on the subject on whether the contact was directly connected to the supplier or just a middleman, as long as they have the access to the production facilities, and the goods arrive on time and met specified price and quality.

6.5.2 With or without a little help from your friends

Instead of using intermediaries to search for new suppliers most of the companies in this study used some sort of industry intelligence, whether it is the inside-tip from a previous position or a suggestion from colleagues in the same industry. The use of references to attract industrial customers has gained some attention by researchers (cf. Ruokalinen, 2005; Salminen, 2001 and Saminen and Möller, 2004) and the advantage of entering behind the giants is of course that you may benefit from their cooperation with the suppliers. The positive side to the use of references is more or less taken for granted in these articles. One of the cases above however elates another side to the use of references by Chinese suppliers; the fear of copying. DSGN3 expressed some degree of scepticism towards using the same supplier as the immediate competitors; that if they came up with a really innovative idea this idea might have been passed on by the supplier to other customer. Although the fear of being copied in the seasonal industries are rather low in general, usually the life span of a model is not long enough for the copy to take away too much of the market, it is also an industry where the differences between products are in the details and the details are hard to protect in the long run (Burns et al, 2007). At the same time the ability to avoid using the same supplier is restricted by the demands of fabrics suppliers such as GORE-TEX that dictates what factories may buy and produce clothes using their fabrics. The seemingly frequent use of the suppliers of previous employers may also give birth to interesting research and manager implication. There is of course the twist that you eventually will use the same supplier as one of your Swedish competitors, but above all it tells us something about the relationship that evolves between the individuals employed or owners of the Swedish companies and the Chinese representatives. It tells us that the relationships are extended beyond the actual orders and beyond the present company relationship.

It was also interesting to note that from this small sample, there were many cases where the contact between the Swedish buyer and the Chinese supplier took place prior or in the early phase of the establishment of the Chinese company. Luck? Maybe, but the advantage seems to be that the relationship developed in a time where the Chinese supplier was more open to small
6 On how to source from China

volumes and maybe also more flexible towards the Western business culture, eager to find compromises to fill up the orders. As both the Swedish and the Chinese companies continue to grow there seems to be no need for, or just hard to add, an intermediary to the equation. Studies on supplier development are usually made in the context of large companies developing small suppliers (Larsson, 2005) based on the assumption that small companies do not have the resources to invest in the development of a supplier. To have or not to have resources is of course relative and the cases above show the buyer's ability to take advantage of the fact that in the first phase of building up a new factory, the management is usually more prone to accept small volumes and odd orders. All in all relationships between individuals seem to make the companies less inclined to use intermediaries in the search for new suppliers.

6.5.3 Single or multiple sourcing.

The relationships between supplier and buyer are frequently mentioned in the interviews, and looking at the discussion regarding the advantages of single versus multiple sourcing in chapter 2, there seems to be a small tilt towards the single sourcing strategy for most of the companies in this study. The individuals who expressed a clear favour of single sourcing were CEOs, while the respective production managers both declared a wish to have at least one additional supplier as a safety precaution. Just as previous research has indicated – the choice of multiple sourcing usually rests within the industry. Companies such as STD_b (see chapter 6.4.3) that buy price sensitive and standardized products for which there are many suppliers are more prone to see every order as a new purchase with a new bidding process.

The volume of the orders is one of the restricting factors in regards to the number of suppliers in use. The other side of the coin is flexibility. Flexibility has many faces. For the companies producing functional clothing, flexibility might mean one factory per type of clothing, production method, cutting skills etc. It might also mean that you have one supplier for the medium priced products and another for the high priced products. Also companies such as BTO_1 where every order is a new one, containing a new combination of materials and production competences, it is hard to build a continuous relationship with the customers. When the product finally is taken off the market, there is no way of knowing when BTO_1 will be able to place a new order with the supplier. This calls for a very large number of suppliers in use – but only one per product. The need for flexibility also seems to be the reason companies tend to use many suppliers despite having an exceptionally good relationship with one of them. On the other hand, despite very similar mission statements, the supplier base of BTO_1 and BTO_3 (chapter 5.1.6) are very dissimilar. BTO_3 had decided to stick to and evolve in accordance with a limited number of suppliers thus matching the customers to the suppliers while BTO_1 were on a constant search for new suppliers to match their customers,
which means that the costs for searching and evaluating new suppliers are higher.

Above all it seems that in these cases, the use or non-use of intermediaries in finding and evaluating suppliers is connected to turnover of the supplier base. For the producers of functional clothing and seasonal design goods, although the design is new, the same type of suppliers are needed season after season. The company that produces standardized products, although using a multiple sourcing strategy, had limited the number of suppliers to a fairly stable set of suppliers that are continuously approached when new inquiries are sent out. The turnover within this set of suppliers is low. It is BTO\textsubscript{1}, the company dealing with complex metal components for larger Swedish customers, that seems to have the largest turnover in suppliers and also the only company that really uses intermediaries in the search for new suppliers.

### 6.5.4 Evaluation of suppliers.

The importance of presence, experience and technical competence runs through most experiences of the respondents. To trust the evaluation trips and evaluation scripts is hard. It is not only a question of trusting the suppliers to be open about their own production but also about their sub suppliers conditions. Both BTO\textsubscript{1} and DSGN\textsubscript{3} described how sub suppliers, with no English speaking personnel were visited with the supplier’s sales or contact person. This person, was then acting both as part in the negotiation and translator, which gave him or her control of the information flow. This situation could become sensitive, especially if there were complaints on the sub suppliers. There have also been occasions where the Swedes have felt uncertain as to if the factory they are visiting really is the factory where the goods they have ordered will be produced. The machine park does not fit the type of production in question. When all conversation runs through the sales representative, the answer is of course that they are at the right place. The trips to China are usually fully orchestrated by the Chinese sales representatives. They know when the delegation arrives, what they will do, and when they will leave. Although possible in theory, the buyers do not seem to fly from Sweden to China during production. To fly in without the help of Chinese contacts would be difficult for small companies since they often have several small orders out and many different suppliers to visit.

The delegation visits to evaluate suppliers seem to follow the same script. Are they certified, do we trust the certificates, do they have references, is it neat and tidy, do they have the machinery needed, do they have employees skilled enough to use the machinery right? At the same time there are many tales that display that it is just not that easy. One of the respondents above admitted that the factory of one of their main suppliers is not really neat and tidy but the products are high in quality and always on time. So what does that say about the inspections? How can you really tell by just looking through a factory, the
quality of the goods or the situation for the personnel? And how about the relationship and open atmosphere to learn from mistakes? The case of STDb is interesting here. Although the supplier evaluation has developed into a formalized system, the purchasing personnel confess that they repeatedly cheat the system. They change the figures in order to be able to send an inquiry to suppliers who score too low – despite the confidence of the Swedish contact person.

6.5.5 Preparing for the take off

Some companies take it slow, preparing themselves for the change, listen to the experience of others that have gone before. Others plunge in; head first to make the change. How do you do it? For the companies in the study who had or have production in Sweden the decision has profound consequences. First of all, will the decision affect the Swedish production personnel? In the case of DSGN1 more or less the whole factory was laid off as soon as the decision was final. In the case of BTO2, no real changes affected the existing production in Sweden. In both cases however the process went quickly. During the interview the CEO of DSGN1 at the time of the outsourcing decision repeatedly returns to the importance of timing. His vision is that it must be done quickly. It took a little longer for BTO2, but then again, they decided to set up a whole factory of their own. One of the results of sending the production line to the other side of the world is of course that the new process must incorporate longer lead times and routines for detailed specifications. In the case of DSGN1, this was not prepared and the company was forced to find competence outside, who could help them get ready.

Another question to this is the costs involved. BTO2 was more or less pushed into the Chinese market. There was no time to financially prepare for this start up but on the other hand the whole project was funded by collecting the gains that they made when they no longer had to ship the products from Sweden to China. Other companies hope that selling to the Chinese market might cover the costs of having an office in China. None of the companies in this study had yet arrived at a position that this had been fulfilled.

6.5.6 An extended understanding of how Swedish SMEs source from China.

Though some companies seem to follow the process models; sourcing directly from the beginning does not seem to be too difficult for the companies in this study. Although intermediaries are used at times to find and evaluate suppliers and/or to negotiate prices, this seems to be frequently done directly without the help of intermediaries in China. To listen to competitors or previous contacts facilitates the process of course.
Then when the products are in production something happens in the company that source directly. Despite contracts, quality sometimes fails and products arrive late. The geographical distance that was unproblematic as long as everything ran smoothly now becomes problem. This means that some of the companies (see for example DSGN1), although starting off sourcing directly begin to search for an intermediary to represent them in China (see figure 6.2). Looking at the different types of strategies used by the cases in this thesis, the strategies are as varied as the cases. There are some that source directly with no use of intermediaries (such as OMc and BTO1) and some that established a subsidiary directly (such as BTO2 and OMb). Although many cases use intermediaries there seems to be different ways to use intermediaries. Some companies seem to prefer to let the intermediary in China do all negotiation and translation whereas others seem to wish to stay in control and thus let the intermediary only do the quality checks. Interesting is also that the market access that was not mentioned as a reason for starting to source from China in the first place, are frequently mentioned as a prerequisite in order to make an investment in a subsidiary pay off.

Figure 6.2 Intermediary functions in China from the perspective of Swedish SMEs
Theme
Organizing for Quality
7 On how to design a Sino-Swedish value chain.

The cases presented in the first two themes (chapters 5 and 6) represent a number of different industries and products. It might be argued that the wide arrange of companies is needed to display such a rich array of different ways of arranging a supply chain. Looking closer however it becomes clear that among the four companies that are labelled design goods for consumer markets these four companies alone represent four very different approaches to sourcing from China. This theme will thus look closer at the supply chains of these four companies – DSGN₁, DSGN₂, DSGN₃ and DSGN₄.

7.1 Organizing for Quality

If production leaves the company – how long will it take before design and other vital functions also leave the company? The companies in this study represent different types of products and industries. From industrial components to designed customer garments. With such a broad spring board it is hard to see anything but differences. If there are two things that all these companies have in common it would be the high emphasis that the respondents ascribe to the “good relationship” (regardless how they interpret this) and the constant affirmation that even if production has been off shored, the competence (design most of all but also production competence) remains within the Swedish company. But even if the basic idea is the same, the actual design of the value chain differs remarkably, even among companies that have similar products. This chapter focuses on four companies that have one thing in common; they all produce non-standardized customer goods aimed at the markets of the northern hemisphere (i.e. Northern Europe, Canada, USA and Russia). Though only three of them are textile companies with focus on functional clothing, the fourth company produces accessories. The design of these products is thus Swedish, and as they market themselves it is the Swedishness that is pronounced. Yet, today none of the companies have any production at all in Sweden and most of the products are produced in China. Creating designer goods, to the right price and quality thus became a continuous long distance balance act, a balance act that the companies have chosen to solve in very different ways, using intermediaries in different ways.

In the stories below, the word supplier will refer to the full garment manufacturer or in the case of DSGN₃, the final product manufacturer. The factories of the suppliers were all situated in the People’s Republic of China,
although the head offices were sometimes situated in Hong Kong. The word sub supplier here refers to the suppliers of fabrics, trims or material that goes directly into the supplier's production.

### 7.2 On Quality and production knowledge - Design1

DSGN1 differed from the other three companies described in this chapter in two distinct ways. First of all, the product was not functional clothing. The product however was very similar in the sense that it was a consumer product for everyday use where performance quality was of outmost importance. The products were launched seasonally four times a year although internally the sourcing processes were run as two seasons. The average life span of a product was estimated to be approximately 2 years with huge variations depending on the design and intended segment. The profile of DSGN1 on this market was also resting solidly on design and the products were in the upper price segment. The second way in which DSGN1 differ itself from the other three companies was that up until the turn of the century, the major part of the production was in-house (see chapter 5.3.1 and chapter 6.3.1).

#### 7.2.1 The processes of DSGN1

The first six months after the decision to outsource to China became very turbulent, and it became very evident that the company was not fully prepared for the change. As described in chapter 6.3.1 the first challenge was to learn how to make appropriate blueprints and templates for the Chinese suppliers. The second challenge concerned the routines. Production and craftsmanship had previously been the core of the company, resting on the values of the Founder and as long as the production was in the same building the different departments were able to work very closely. The design team could easily go down a floor and ask production to make a production sample of a model that was later discarded, without any major costs involved. If it was a good model, it could be in production without any delay. The after sales service could talk to the production managers with the customer still on the line if there was a problem with the product. When a product was out of storage, the waiting time could be kept at its minimum. With production in China, this would all have to change.
Figure 7.1 The supply chain of DSGN₁
An external consultant (who later became the CEO) was contacted and he quickly recognized two major processes – Design, Product Development and Sourcing (i.e. upstream) and Marketing, Distribution and Customer Service (i.e. downstream) (see figure 7.1). Based on this DSGN1 began the task of reinventing themselves as a knowledge intensive company as opposed to a production intensive company and the journey from a line organization to a process oriented organization began.

Before the decision to close down production in Sweden, DSGN1 was already buying 40 per cent of their products from an Italian company. The Italian company worked independently in the sense that they were responsible for the whole product – from design to finished product. Despite this there had been a continuous cooperation between the design department in Sweden and Italy, for the exchange of ideas. The rest of the products, 60 per cent, were outsourced to China. Here the process was quite different. The products that were produced in China were all designed in Sweden. In addition to their own team of designers, DSGN1 had a of special collection, by freelance designers that used their own brand name in addition to the brand name of DSGN1. All of these designs were produced in China. The raw material was for most part European, but the costs of production in China were so low that there was no way for the Italian company to compete on a cost basis. DSGN1 showed the offers from the Chinese supplier to the Italian supplier who was taken by surprise. Although DSGN1 assured him that they would continue to buy products from Italy, that they needed the additional guidance for design and insight in European trends, the Italian supplier questioned how long that competitive advantage will sustain.

The new sourcing process that was established after the first sourcing venture stretched over one and a half year (as opposed to the 4-8 weeks that they had when production was still in-house). The process from design to finished product started with going through feedback on previous assortment and looking at trends on the fashion market. Freelancers were contacted and instructed. Sketches were made, evaluated and some discarded. When DSGN1 first started to source from China, all pre production samples were made in China, and sent to Sweden for inspection. When production was closed down in Sweden, DSGN1 decided to keep most of the machinery, some of which were very modern. In order to capture the flexibility of the design process from the era when production was on the ground floor, DSGN1 started to put these machines into action and moving towards making their own prototypes again. This decision had proved to be valuable. It meant that they made sure that the technical knowledge remained in-house, that the craftmanship needed for the product was passed on to new employees, it meant that the distance between the writing board and the prototype remained small. For a product that was very closely connected to the northern European complexions this meant that they were able to test models on individuals from the target market before they even decided to discuss the price in detail.
About nine months before planned arrival, the Chinese suppliers were involved and began to make the pre production sample. DSGN1 was at the time of the interview working with two Chinese suppliers, one main supplier who was responsible for approximately 50 per cent of the products and a second supplier responsible for 10 per cent of the total product line (see figure 7.1). The two suppliers work independently and with similar products, though due to size of volume not on the same products. This means that in a critical situation the production could possibly be moved from one factory to the other, but also that even if not all could be moved at least a couple of the designs within a production line may be unharmed by unexpected events.

Before the final decision on what designs were to be part of the final product line was taken the head designer discussed with the company’s sales representatives on different markets as well as Swedish retailers. When the final cut was made the negotiations with the Chinese suppliers entered the next phase. The Production Manager usually made about 6 trips a year to China, but on the negotiation trip where new products were discussed he was accompanied by the Head Designer or someone else from the in-house design department. These meetings most often took place at the suppliers’ office, with the sales representative and other representatives that were called in depending on what was discussed. The main supplier was the same supplier that produced the first Chinese batch of products after the decision to offshore. The second supplier had been exchanged at one point in time. Stability was important to DSGN1 in order for the relationship between buyer and supplier to evolve. The long-term view on supplier relationships was emphasized by all involved in the sourcing process at DSGN1. Complaints were handled continuously as one part of the discussions with the suppliers. To the Production Manager, the attitude towards handling the complaints was one aspect of a good relationship. There was a continuous emphasis on how to help the suppliers with improvements and since they had held on to the technicians they had the competence to do so, when and if the Chinese suppliers were willing to admit the problems. DSGN1 often experienced that the Chinese suppliers were reluctant to admit that they had any problems or that they did not have the competence to solve a particular problem. DSGN1 felt that they continuously had to emphasise that they were willing to continue to do business even when there were problems and that they understand that these problems will not be solved over night.

In order to facilitate the quality improvements and communication during production, DSGN1 had chosen to work with an intermediary in Hong Kong which was contracted long-term commission. Thus the intermediary was guaranteed a certain amount of hours per month but was free to organise the quality work and visits themselves. This intermediary was involved as early as in the specification process, before the actual order was placed. The intermediary was then able get a preview of the order before it was sent to the supplier and was able to give feedback to DSGN1. Apart from making random visits at the company the intermediary also makes visits whenever DSGN1 felt there was a
need. Instead of approaching just the management or sales representatives, this intermediary works on all levels. Here again the technical competence within DSGN\textsubscript{1} filled a purpose. The intermediary had long experience in doing business in China, had profound knowledge about Sweden (culture and language) as well as China (culture and language), but no technical know-how about the specific product. This lack of knowledge was compensated through the possibility for the intermediary to contact the technicians in DSGN\textsubscript{1}, and thus keep a free communication between the Swedish employees and the Chinese employees.

When the products finally arrive in Sweden the responsibility was taken over by the downstream process. The products go directly to the new automated storage at the headquarter of DSGN\textsubscript{1}. The reason was twofold: the final random quality-checks but above all repackaging. The products arrive in boxes divided by design but were sold in units. DSGN\textsubscript{1} had their own sales personnel in Sweden who travelled around to the stores to sell their products. A new business system were introduced a couple of years ago to suit the automatic storage system, which meant that the sales personnel were able to get the exact number of products left in storage of a certain design on their computer and as they place the order from the customer the system was directly updated.

7.2.2 Activities of DSGN\textsubscript{1}

In figure 7.2 the process from design to storage is outlined. Above are the five actors involved, though in this case the sub suppliers are coloured grey since they are outside the horizon of DSGN\textsubscript{1} and thus it was up to the suppliers to make sure that the material used held intended quality. As may be viewed in figure 7.2 DSGN\textsubscript{1} had kept control over the design and pre production sample, involving the retailers only to check the marketability of the product. By taking back the prototype production, DSGN\textsubscript{1} had managed to facilitate the early interaction between design and production. Designers were now able to see their drawings and blueprints take physical form, evaluate them and discuss them with their sales people and retailers without involving the Chinese suppliers. When they finally did sit down to negotiate a new order, they had already tested different materials and colours.

Not until all specifications and blueprints were finished did the designs leave Sweden. The intermediary was not really involved in the negotiations but checked all agreements just in case something was unclear. The arrows in the bottom of figure 7.2 showed the point in time when quality checks were made and by whom. Preproduction samples were sent to the head office of DSGN\textsubscript{1} where the quality was checked. During production the intermediary usually made the three customary visits; pre production, during production and after production. These were planned together with DSGN\textsubscript{1}, but since the intermediary was not paid exclusively for these visits they sometimes added visits if necessary.
Figure 7.2 Distribution of activities in the DSGN, supply chain
DSGN₁ stressed that the intermediary should act in their interest as a full representative of the buyer. A mentioned above, this meant that the intermediary was able to work at all levels within the organisation of the Chinese supplier and able to involve DSGN₁ in the quality improvement work when needed to enhance an open communication between buyer and supplier.

The final quality check was made at the head office in Sweden, where the products are stored. Keeping the storage in Sweden allowed for flexibility. It made it possible for the retailers to buy small volumes of each model and kept the lead times between DSGN₁ and the retailers at a minimum.

7.3 On Quality and cooperation - Design₂

The turnover at DSGN₂ exceeded by far those of the other two functional clothing companies in this study, and the company's overall strategy was very different. DSGN₂ did not export any products nor sell to retailers, but sold all products in their own network of stores. The pricing strategy was to be at the lower end of the scale of high performance quality clothing, and thus quality was emphasized in the marketing and by the Purchasing Manager⁷.

The sourcing strategy also differed markedly to that of most other companies in this thesis. Instead of using a basket of different suppliers, DSGN₂ had chosen to cooperate with only intermediaries. The line of functional clothing was produced in China. Summer season was the peak season for DSGN₂, and at the time of the interview they were only making one apparel line that arrived just before summer. There were plans to extend this to a winter season as well as trying to get an earlier production time so that they might get the garments earlier than the last of April.

7.3.1 The processes of DSGN₂

In China DSGN₂ used two different intermediaries to produce their garments. One was a Chinese company which had been DSGN₂'s contact since it first started to buy from China in 1991. This intermediary had manufacturing capacity not only in China but also in Vietnam and Cambodia and other Asian countries. The other intermediary was a Danish man who had established his own firm in China, and had bought production capacity from different large Chinese manufacturers for the benefit of his European customers. The ratio between the Danish owned intermediary and the Chinese owned intermediary were 50/50. The production capacity of both companies was very large and the

⁷ I haven't found any independent test where products from this company are presented although customer online stories at web pages for outdoor activities such as www.utsidan.se display high satisfaction.
purchasing manager estimated that the factories that were used to produce DSGN2 garments were somewhere in the size between 500 and 2000 employees, but the manufacturers were really beyond the line of visibility for DSGN2 (see figure 7.3). The reason why DSGN2 was able to keep their position with these large manufacturers was, apart from the relationship between the intermediaries and the manufacturers, the timing of their production. They had decided to place their production orders in low season, just after the manufacturers had finished all large orders. This however meant that the products did not arrive until late April which was really too late, as their competitors had then already managed to get their products up for sale. Thus by using the low season of the manufacturers, placing their production orders between the orders of the larger customers, the comparatively small batches of DSGN2 suddenly become interesting for the manufacturers.

Instead of having designers employed in Sweden, design at DSGN2 was more of a co-operation between the Swedish CEO/owner and the intermediaries in China. In September a team from Sweden, including the owner and the purchasing manager, joined a team in China consisting of, amongst others, designers, assistants and representatives from the different manufacturers for one week of intensive work. Before the meeting DSGN2 might have given the intermediary a hint as to what kind of products they were looking for, but the whole process was based on cooperation. DSGN2 brought sketches on the designs and then the intermediaries and other representatives of the manufacturers gave suggestions of design, fabrics and trims. The intermediaries also made the actual drawings and patterns.

During these meetings they discussed what fabrics to use and what zipper to use etc. The involvement from the Chinese part was a balance act. On the one hand they had to be careful not to expose too much of the designs and technical solutions of other clients, while at the same time they were eager to pass on their own design and technical solutions in general to their other clients. It might be a new type of zipper or a new fabric. Especially so, since there were additional benefits for the Chinese supplier. If the supplier managed to persuade DSGN2 to use the same fabric as previous customers, they could get rid of a surplus and/or get the fabric even cheaper as the volume increased.

The critical element in the design process was the fit. Especially the collection for women was thoroughly discussed and the Chinese suppliers were at times amazed at the sizes that were ordered. The intermediaries were keeping themselves updated on the Nordic market. The Danish owned intermediary made regular visits to Europe but the Chinese owned intermediary also made visits from time to time, especially in connection to a German trade fair or similar events.
Figure 7.3 The supply chain of DSGN$_2$
As the Swedish team returned home most of the planning was done. What was left to figure out was how much of each model and what colours to order. Factories were not visited at a regular basis. When a new factory was added a visit might be paid, otherwise the intermediaries were in full control. The purchasing manager pointed to the expensive fabrics as a guarantee that the factories were serious about quality. It takes skilled labour to work with the type of fabrics used for functional clothing.

DSGN\textsubscript{2} suggested which factory that should manufacture the goods based on their experience of the quality of the goods that had previously been done at each manufacturer and their respective delivery times. This was however mostly based on the request to the intermediary that they should use the same factory as last time for similar garments. There was no real possibility for DSGN\textsubscript{2} to know if this request was granted or not though judging by seams or other details they sometimes suspected that other manufacturers had been used. Only when there were some real quality problems did DSGN\textsubscript{2} demand to know which supplier was responsible for the shipment. Or when the garment suddenly was much better. The intermediaries however would often claim that the supplier was the same.

In the case of DSGN\textsubscript{2}, all contacts went through the intermediary except for invoices and payments for which there was a contact person assigned at the factory, and transportation and logistics for which another person at the factory was assigned. Everything else; design, quality, pre production discussions, sales confirmations, went through the intermediary. The Purchasing Manager often returned to the issue of trust. On the one hand he realizes that the prices could be lower, had they chosen to go beyond the intermediary to discuss with manufacturers directly. At the time of the interview there was no interest for this, however. The intermediaries penetrated the cultural barrier and handled all the quality issues during production. There were times when the language barrier between the intermediaries in China and DSGN\textsubscript{2} caused communication problems. Some quality issues were hard to explain in English when the physical distance is large such when the material of a particular product has been made in a rougher material than the one agreed upon.

If I got a sample that I did not like it would have been easier to be able to just point to show that this needs correction. Last year we had a jacket. The season before it was produced in black only and this season we used three different colours. We perceived the new jacket to be much more creased and how do you explain this to the Chinese supplier

(Production Manager at DSGN\textsubscript{2})

The jacket resulted in an email discussion where the supplier claimed that the problem was in the fabrics, whereas the Swedish purchasing manager of DSGN\textsubscript{2} claimed it to be a production error.
Finally, instead of trying to get this down on an email the purchasing manager resolved to wait and bring the issue up next time they met. On spot, the issue was quickly resolved when the supplier had the jacket and was able to look at it closely.

Looking at the relationships from DSGN₂’s point of view, there was a close
cooperation between suppliers, intermediaries and buyer. The close relationship between these three actors made knowledge sharing easy, but in this type of process DSGN$_2$ had only marginal insight in the facilities in which their products were produced, and no insight at all in the facilities of the sub suppliers.

### 7.3.2 Activities of DSGN$_2$

Figure 7.4 shows an outline of the process of DSGN$_2$. In contrast to the process by DSGN$_1$ there are no retailers since all products were sold by DSGN$_2$ in their own stores. Sub suppliers and suppliers were not visible to the company and thus the quality controls were not done by DSGN$_2$.

The design process was an interaction between DSGN$_2$ and the intermediaries. From Sweden DSGN$_2$ placed the orders, specifying number of each garment and in what colours. Samples were sent and carefully looked through as they arrived. Corrections were made and sent with returning mail back to China and then a pre production sample was sent to Sweden before the production started up. The only trip that was made from Sweden to China was the one in relation to early design meeting. It had happened that somebody from Sweden had taken the time to go on an extra trip to China for a specific reason, to solve something that had come up but this was more of an exception.

During production there were no quality controls ordered by DSGN$_2$, this was left to the intermediaries. All products went directly to Sweden where a final quality inspection was made. The purchasing manager stressed the importance of quality and pointed to how very few complaints they really had. The final product and the production sample were usually the same. Since all products were sold in their own stores the final quality control was rigid as products were hung in the store and the closeness to the customer made feedback easy.

### 7.4 On Quality and trust – Design$_3$

DSGN$_3$ offered two types of functional clothing garments. First they had an apparel line of designed customer garments that the CEO/Owner referred to as high quality for medium price. The company also offered garments to industrial customer for special events, for example with the customer logo. Quality was a subject that obviously was close of the heart of the CEO of DSGN$_3$ who devoted a large part of the interview to this discussion. The presentation slides, printed on paper, that he flickered through as he talked were filled with references to different tests and ratings of brands in the industry. By these tests the company was doing well on quality especially when
the tests were based on customer ratings.

To the CEO of DSGN\textsubscript{3} quality in functional clothing was a balance between using enough parameters to really assess the function of the clothes and finding a good way to communicate the quality to the customer. As an example the CEO referred to a very common measure for functional clothing in Sweden called \textit{vattenpelare} (i.e. centimetres of water) that indicates the level of water resistance in the fabrics. Together with ability to breathe the mark had become very popular among retailers as it is easy to communicate to the customer, but the CEO of DSGN\textsubscript{3} refused to add this label to his clothes. There were so many other things that may affect the customers’ perception of the quality that was not included in this type of quality assessments. According to the CEO, the mark did not tell whether the functions would still be there after the garment had been washed which is an important feature in functional clothing. The fit was also important in functional clothing since a bad fit will make the garment more vulnerable to water leakage.

The CEO thus divided the quality of a functional clothing garment into three types of quality. Firstly, the quality of the fabrics, measured with different laboratory tests. This was the quality that was frequently used by the retailers in their communication with the end customers. Secondly, the quality in terms of design and construction of the garment, which was related to how well the garment fits the customer. In functional clothing the fit may affect the overall performance of the garment. Finally, there was the production quality, which referred to how well the garment was cut, sewn and made water resistant through for example taping of the seams.

7.4.1 \textbf{The Processes of DSGN\textsubscript{3}}

DSGN\textsubscript{3} bought full garments, which means that the supplier from whom they buy the garment was responsible for making sure that the garments fulfil all specified requirements. This means that the suppliers are also responsible for what the sub suppliers deliver should such be used. Thus the supply chain beyond the manufacturers was not visible to DSGN\textsubscript{3}. Most of the fabrics came from China, with some exceptions. DSGN\textsubscript{3} encouraged the suppliers to buy locally although they preferred not to interfere in the supplier’s decision of sub suppliers of fabrics and trims. They might have suggested but did not decide.

The design department kept up with what was available (new fabrics and new trims) through sources such as trade fairs, magazines, industry journals etc. The suppliers themselves may of course make suggestions but there was no one-on-one contact between the sub suppliers and DSGN\textsubscript{3}. The sub suppliers were required to make independent tests of their fabrics and to make sure that all certificates were in order. The consequence was of course that the contact between the Swedish representatives and the sub suppliers were only sporadic, usually when something had gone wrong, and always together with the sales representative of the supplier.
7 On how to design a Sino-Swedish value chain

Figure 7.5 The supply chain of DSGN₁
Language skills had of course not been a prominent factor for the Chinese supplier in their choice of sub suppliers and this was the only time that DSGN3 found themselves in need of a translator. When problems arise, regarding a trim or a zipper for instance, the meetings with the sub suppliers were handled through the suppliers which meant that DSGN3 could never be absolutely sure that the supplier was giving them the correct translation or just the translation that will made the supplier look the best.

At the time of the interview, the design department at the head office in Sweden consisted of four employees and one freelance designer. Although export was increasing, there were no intentions to adapt design to new markets. Instead of approaching countries in the southern part of Europe where the differences in climate and body sizes demand adaptation, they had chosen to work latitudinal. The patterns were made in China. There was no special competence within DSGN3 for patternmaking and the competence among the suppliers was considered impressive. Though the suppliers were not involved in the design of garments there were a tendency that the designs were becoming more and more elaborate which increased the potential that the quality of the garments might falter. The patternmakers were constantly trying to save fabrics by making the patterns as tight as possible.

DSGN3 tried to keep the number of suppliers down and the suppliers that they had, were contracted based on their special competence or capacity. Keeping a limited number of suppliers was considered especially vital in order to keep a long-term relationship with the suppliers. It might easy to handle a business relationship on distance when everything goes as planned. When something goes wrong, is when the relationship is tested. The CEO explained that since they knew that they would be back for another order next season it was important that all agreements were on a win-win basis. According to the CEO of DSGN3 there were many dimensions of this. From the understanding that fluctuations in the currency will lead to renegotiations if one party looses too much, or when the quality fails they need to find a long-term solution to handle complaints. The Chinese suppliers often asked that refunds should be deducted from the next order. Even if the supplier accepts responsibility for the quality failure, they are still forced to pay the sub suppliers of fabrics and trims. Considering this, DSGN3 tried to find a solution that would be satisfactory for the Chinese supplier as well.

The most frequent problem however was not quality per se but on time deliveries. Once the sample was cleared and all specifications were in print, the production enters a phase where much of the control was handed over to the Chinese supplier. Although there was an agreement between the supplier and buyer on when the order would be in production, DSGN3 sometimes experienced that they were not notified if the production start was postponed or fabrics arrived late. It was also hard for the Swedish company to gain real insight into whether the products that were being produced had the same standard as the sample that arrived. It had happened that when the final batch

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arrived, there were quality problems that were not on the sample – maybe a
different colour or fabrics, or tapings that did not stick. In these cases the CEO
of DSGN felt that he was always notified too late, when there was nothing
they could do about it. For the CEO of DSGN it had become a matter of
trust. He seemed to feel that had the Chinese supplier trusted DSGN to
understand and be willing to accept a temporary setback, they would have been
alerted earlier.

In order to handle the uncertainty during production, DSGN had chosen to
work with quality controllers (QC) from time to time, especially when the order
was important or extra valuable. The QC company was called in when needed,
and the amount of control depended both on the product and the status of the
relationship between DSGN and the supplier. The QC centres were temporary
solutions. Finding a QC in China today was almost as easy as finding a supplier
according to the CEO. During the ten years of sourcing from China DSGN had
already tried a few different QC’s mainly with European ownerships. The
problem did not seem to be dissatisfaction with the external QC, but rather
finding the right technical competence and flexibility to act as a full
representative of DSGN. The contract between the QC and the Swedish buyer
usually consisted of a specified number of visits and specifications regarding
what the QC should look at during these visits, for which a sum was paid. The
flexibility beyond these visits was low.

Apart from using an external QC, the company was also regularly sending
personnel from the Swedish head office to meet with the suppliers. There were
at least five persons, including both owners, who travel regularly twice a year,
which meant that a representative from Sweden was on location in China
almost every month. The travels took place mainly during the early negotiation
phase and during the production phase.

DSGN sold their apparel line in 12 different countries today, although the
export was still small compared to the domestic market. Apart from Norway
where DSGN had a subsidiary and the UK that was handled through an agent,
DSGN was little involved in the relationship with the importers who mostly
sold to independent small shops. The reason for the lack of connection with
larger retailers was more a question of size than of actual strategy.

The importers at the export countries met in Sweden and were subsequently
introduced to the collection of the season. The importers then chose the
garments which they wished to purchase from the DSGN catalogue, if and
what part of the pre produced marketing material that they wish to use and
placed the order directly to China. The goods also went directly from China to
the importers in their respective country, and had done so, basically from the
beginning. Through this system DSGN had shorten their lead times although
they lost the opportunity to make random tests in all batches.
Figure 7.6 Distribution of activities in the DSGN₂ supply chain
7.4.2 Activities of DSGN3

Figure 7.6 shows the activities of the DSGN3 supply chain, just as in the previous cases. Again the transparency of the supply chain did not really go beyond the suppliers for DSGN3 and quality controls beyond that line was made either by the suppliers or through the presentation of internationally approved certificates. DSGN3 continuously tested different fabrics etc. but since they were not in the position to demand a certain brand or supplier of fabrics their suggestions to the supplier meant little beyond just that, a suggestion.

Thus the sub suppliers had the responsibility of their own design, product development, making sure that the test protocols were in order. The supplier who had chosen the sub supplier was in turn responsible to DSGN3. Although DSGN3 had storage facilities at the head office, the strategy was to let as much goods as possible go directly to the retailers outside Sweden. This meant that the final inspection was only made on the goods that arrived in Sweden, which was considered a sufficient random sample since there was always a batch from each apparel line that ends up in the Swedish storage.

If following the initial discussion on quality the first quality (fabrics and trims) was certified by the supplier. The design quality was the responsibility of DSGN3 and the production quality was the responsibility of the supplier. DSGN3 trusted most of their suppliers to produce in accordance with the final pre production sample – and most of the time they did. Only on occasions where there was cause to be extra careful (special order, new material etc.) did they use an external QC for quality inspections. A final inspection was always made randomly when the products arrived in Sweden. This meant that material and pre production samples were continuously sent back and forth to China for inspection, testing and then for evaluation at the suppliers.

The actual control over the quality of fabrics thus came down to two things for DSGN3. First of all to be specific in their orders, so that the garment really fulfilled what the company expected, and secondly to continuously test fabrics to maintain a firsthand knowledge of what different fabrics were able to perform. Some of the tests that DSGN3 required were not made on a routine basis by fabric producers, and thus DSGN3 tested all the fabrics at the head office in Sweden.

7.4.3 Thoughts on a Subsidiary

As mentioned above, DSGN3 used intermediaries from time to time in order to solve temporary quality issues. It was when quality failed that the physical distance and the nature of relationships became important. During the interview, the CEO of DSGN3 gave an example.

A shipment that was supposed to have left the Chinese harbour just before the Chinese New Year was not on board the ship. Despite numerous
conversations with the supplier who asserted that the products were finished and on their way they were on their way to Sweden. This was just the culmination of a whole series of problems with this order. It had started with the fabrics from a Taiwanese supplier that did not hold the agreed upon quality, followed by problems with the taped seams and details. The product was stopped by DSGN3, adjusted and new instructions on how to solve the problems were given. When the new sample finally arrived in Sweden, the quality problem was still not solved. This opened two alternatives – either to break the contract or to believe the supplier and bring the products home by air in order to get them to Sweden on time.

In this particular case DSGN3 decided to trust the supplier and hope for the best. Time was running however, and since the type of functional clothing that the company produced are bound seasonally, the jackets would become impossible to sell if they arrived too late. When the products finally arrived, by air, it turned out that after two washes some of the taping fell off. Suddenly it was a case of complaint that needed to be handled.

One part of the problem was the shipment of jackets that now were in Sweden. They could not be sold through their normal market channels since that could have damaged the brand name, not even at a reduced price since a jacket that is not possible to wash is hard to sell. The alternative to burn the clothes would equally upset the market if it became known by their environmentally conscious customers. Thus they needed to find a market – preferably one that they were not selling their products on and that was not too far away so that no costs for transportation would be added.

The second problem concerned the retailers. Since the apparel lines were sold to the retailers before they were produced the jackets were expected by the retailers in 11 countries. If it had been a high volume product or, even worse, a product that was part of a special offer sent out to the final customers – this could have caused serious damage to the relationship of to the retailers and the customers.

The third problem concerned the supplier. The supplier was one that they had had a long and fruitful relationship with before. They still did not know exactly why the problems had occurred but they knew that they would most likely place a new order with the same supplier the next season. To find a new supplier would not diminish uncertainty (after all previous shipments from this supplier had been very good), it would only add costs.

If we are able to make it (sell the jackets) and then pay him 50 per cent or something. We have a dialogue with him right now, trying to find a level where we feel that he is able to survive but we will still be compensated.

(CEO of DSGN3)

To throw the whole shipment in the trash and pay nothing to the supplier would probably be the best short-term solution for the Swedish company. Instead, as the failure became a reality, the Swedish company took on the
responsibility to find a way to handle the situation, not only to the advantage of
the Swedish firm, but also for the supplier with whom the company felt that
they had a long-term relationship. The lack of information made the problem
worse, but the suppliers kept claiming that they would solve the problem. For
DSGN3 there was as mentioned only two alternatives in that particular
situation; either to believe the supplier and wait (and according to the CEO
most of the times this alternative would pay off) or to send somebody to China
to visit the suppliers. The quality problems thus concerned both the products
and the on-time deliveries. This is why DSGN3 had begun to discuss the
alternative to set up a subsidiary in China.

We always find out too late. They are overconfident that things will work out in
one way or another and THAT is what we need to put an end to. THAT is what
causes our quality slippage. The instructions were correct from the beginning,
the counter sample is great and so on, but then something happens at this point.
Then they will rely on their capacity or they might feel that the money is slipping
through their fingers and if they are not able to solve this then they won’t get
paid. This is the real quality hazard to me.

(CEO of DSGN3)

Quality control was a continuous concern and especially in the last couple of
years as the collections had continued to grow, and the interest for an on-site
establishment had matured. Among other things to avoid sending fabrics and
sample garments back and forth. New materials were constantly making their
appearance on the market. As an example, the CEO of DSGN3 recalls a stretch
material that entered the market a couple of years ago. The material quickly
became very popular among the consumers but production wise it was tricky.
To use the material meant extra checkups and frequent discussions regarding
how to get the best fit. On the other hand if they refrained from using the
material they gave their competitors a lead. Although the CEO professed that
many of the tests that were made prior to the production were not too difficult
to make per se, DSGN3 was still responsible towards the consumers and retailers
that the garment will held what had been promised. Since most of the material
was bought in China, there was a constant flow of materials and sample
garments between Sweden and China. So it was not the level of difficulty in
testing but rather the amount of testing that was the issue. Counting all the
garments, models, fabrics, colour combinations – all in all there were tens of
thousands of water tests to make.

The main problem perceived with using an external QC was the way that
these QCs work according to the CEO. Usually the contractor (i.e. the Swedish
buyer) pays the QC for doing a number of surprise visits. The downside to this
cooperation was usually the flexibility. The QC made the controls based on a
check-list provided by the foreign buyer and unless it was on the list it would
not be reported. Quality thus came down to not only making specifications
good enough but making the QC checklist detailed enough as not to miss
anything important and while at the same time short enough to make the extra
costs of using the QC worth the money. Thus the use of an external QC had been limited to special orders and in the case of changes, such as new production techniques, new machinery or new materials. Despite all previous references to the intimacy of the relationship between DSGN3 and the suppliers the word that was used in relation to quality was most frequently “control”. The intermediary would help to control, not facilitate transfer of know-how.

Most of the goods go by FOB and nine out of ten times the invoice goes directly from the Chinese supplier, which means that most of the suppliers had their own export license. At the moment, there were no intentions to let the planned QC office do the invoices as to be able to claim the VAT tax. To the CEO of DSGN3, that would only complicate the establishment process and raise the costs from the suppliers. The plan was thus to establish a representative office, the most restricted but cheapest establishment form (see the appendix). The actual geographical position of a QC office was of lesser concern. The suppliers were more or less spread all over the north-east coast of China, from Shenjiang to Fuzhou. The main obstacle was finding the right person, a combination of skills (professional and language) and personality. The process of finding a Chinese manager for the IPO was already launched and involved not only the CEO and the co-owner but also part of the purchasing and design team of DSGN3.

Communication takes time and the CEO feared that the process was too slow for those who applied for the job. DSGN3 were cautious and wanted to get to know the applicants. At a distance this takes time. Language skills were important and even if they found a Swedish manager, the company felt that Chinese employees were required. There were also concerns related to the present suppliers. After ten years of sourcing from China, with buyer supplier relationships that had lasted equally long, there were of course thoughts about the effect of bringing a third actor into the relationship. The CEO explained that there were many competitors that used their main supplier to act as the Swedish representative in relations to other suppliers but this was not an alternative that the CEO of DSGN3 would prefer. As mentioned in the cases in previous themes using multiple suppliers was a clear strategic choice for DSGN3, which meant that it was important for DSGN3 that representation should be viewed as independent from other Chinese suppliers and a clear representative of the Swedish company with authority to handle problems and situations. At the same time, the CEO believed that it was important that all information (shipping schedules, final quality checks) was contained at the head office in Sweden. Concerning the amount of travels that representatives from the Swedish head office did, the CEO did not really believe that the establishment of a subsidiary in China would mean fewer trips though the trips might be made shorter.
7.5 On Quality and Control – Design4

The functional clothing made by Design4 was targeted towards a higher price segment and consisted mainly of outdoor garments for men, women and children. Especially the clothing line for children was starting to earn a reputation in Europe. The winter season was 70 per cent of the turnover.

The whole apparel line was produced in China, and sourced as whole garments. In order to ascertain quality, the level of involvement in the whole chain of production was rather high. Through the interview with the Purchasing Manager a pattern emerged of three processes that were all involved in the creation of quality garments: design/patternmaking, sourcing and sales/logistics (see figure 8.7). At the time of the interview Design4 had less than 10 employees and cooperation between departments was very close. In fact the sourcing department consisted of only one employee, the purchasing manager.

7.5.1 The Processes of Design4

As opposed to Design3, Design4 had chosen to be very involved in the process of finding and securing the price and quality of the fabrics. There were of course a set of standard qualities and fabrics that were used from one season to the next, but new fabrics were continuously making its entrance on the market. This process of finding new fabrics to keep up with the developments was also something that was part of the job of the Purchasing Manager at Design4. Samples of materials were sent directly to Design4, so that the quality and colours were evaluated in Sweden.

Thus Design4 had chosen to have direct contact with the sub suppliers. Depending on what type of garment and at what price the garment was segmented, quality controls were made or asked for by Design4. They would either ask for independent tests or test the garments themselves.

The quality controls did not only concern the quality of the fabrics but also the suppliers of fabrics in use. As mentioned in the previous chapter, Gore decided which suppliers that may use their fabrics for production but Design4 were just as specific when it came to other fabric suppliers. Even with the main supplier, Design4 made a very detailed specification with references as to where the trims and fabrics should be bought and at what price. The suppliers may give suggestions but Design4 made the decision.

The quality and function of the functional clothing also depended on the fitting and the measures in the design that should allow for movements. The Founders of Design4 were both designers and had a strong background in the functional clothing industry. All designs were made in-house, by a team of employed designers. This included everything from the design of the actual garment to design of trims and sundries, even patterns were made in-house. In
order to accomplish this, the design team had employees with multiple competences, even to the point where the company designs the trims.

We have a girl working here who is an industrial designer. She is very good at finding technical solutions. Small ingenious solutions. So we do all our trims with logotypes. She also does the outlines and in different dimensions; 3D sketches and so on. She sends them to our trim suppliers. We have a couple of fixed suppliers that we work with so it is not like we change every season.

(Purchasing Manager at DSGN4)

The suppliers of fabrics were mostly Japanese or Taiwanese but the trim suppliers had a Swedish office which DSGN4 was in contact with. Production and logistics of these trim suppliers were usually not in Sweden but “somewhere in the Far East”, as the Purchasing Manager of DSGN4 phrased it. Apart from sales representatives, the Swedish offices of the sub suppliers usually consisted of design and product development. The cooperation between the suppliers of trims involved design cooperation which meant that between the design department of DSGN4 and the design departments at the trim suppliers in Sweden there was a constant exchange of ideas and information.

The Purchasing Manager worked as part of the design team with the responsibility of taking in offers, pricing the apparel line, supervising production, logistics and follow-ups based on specifications, patterns, measures and outlines. Since the fabrics in general were very costly, there was a trade off here between a unique and customer friendly design and getting as much as possible from the fabric in the cutting process. This was something that DSGN4 mainly discussed within the company before sending specifications to the supplier. Although suppliers might be willing to give suggestions during price negotiations regarding how to make the garment a little cheaper, not even the main supplier of many years was really active in approaching DSGN4 to suggest changes.

He [the main supplier] doesn’t really want to touch our design, so to speak. It is a little holy to a customer, but of course if there is a point

(Purchasing Manager of DSGN4)

Thus there was a continuous relationship between the sub supplier and DSGN4 as well as between DSGN4 and the supplier.
Figure 7.7 The supply chain of DSGN4
Before production started the garment supplier sent a pre production sample to Sweden that was thoroughly tested. Sometimes they were even cut apart to expose the inside, to see how threads were fastened and the width of the seam allowances.

On the other hand, depending on the strength of the relationships, DSGN4 were more or less thorough. In time, when the products from a certain supplier were proved to be constant in high quality, DSGN4 felt more secure. One of these was the main supplier with whom DSGN4 had been working from the time of they started. The main supplier started his factory at approximately the same time as DSGN4 was founded and was still the main customer for this supplier.

By working so closely with our main supplier, under so incredibly many years we know each other so very, very well and our cooperation is so tight and we see that as a huge advantage.

(Purchasing Manager of DSGN4)

The purchasing manager usually travelled to China twice a year. The first was in early spring just before or as the suppliers were about to start up production of the winter season collection. At that point every detail of the offer was scrutinized. They started by going through the past designs to confirm quality, look at how new solutions worked out together with the production engineers that were responsible for the lines. Since many of the engineers did not speak English an interpreter was used.

The Purchasing Manager stressed the importance of talking not just to the management but also to the responsible line managers. It was at this level in the organisation that the problems usually arose and where a solution might be found. During these visits the Purchasing Manager also went through the whole factory and looked at the facilities and machinery.

Apart from the main supplier there were another 8-10 suppliers, mainly situated in the southern part of China. Many of these had offices in Hong Kong which facilitated the travelling for DSGN4. The products were usually bought FOB, and shipped to Sweden for further transportation to the respective retailers. In Sweden the garments were tested once more. There was one exception however, the Finnish retailer. The Finnish retailer was considered to be such a large customer that they also received their orders directly from China, FOB.

Sending the products directly to the respective countries would have its advantages, such as lower costs of transportation (economic as well as environmental) and lower costs for storage. On the other had it would mean that DSGN4 would have to let go of some of their control as they were not able to make the final quality test of the products that do not pass their storage. At the moment of the interview, DSGN4 had no plans to change their distribution strategy and send more products directly to retailers.
7 On how to design a Sino-Swedish value chain

Figure 7.8 Distribution of activities in the DSGN, supply chain
The ability to go down to the storage for a final inspection before sending them out to the retailers and consumers was considered to be a vital part of the quality control. The big advantage of having the products stored in the same house as the head office was that they were able to go down among the rackets to find specific garments to really see how they turned out, before they were sent to the retailers.

7.5.2 Activities of DSGN$_4$

Despite the so close relationship with their main supplier, DSGN$_4$ has strived to have full control and managed to so without the help of a representation in China (see figure 8.8). Their solution was to take control from the beginning by staying in contact with the representatives of the sub supplier in Sweden.

It was interesting to note that while DSGN$_4$ was involved in a cooperation regarding design with the sub supplier’s Swedish representatives, DSGN$_4$ refrained from any design cooperation with the suppliers. Not even their most faithful supplier would interfere with their designs. By keeping the competence level high within the company, DSGN$_4$ were able to take control of the supply chain as a whole; even patterns were made in Sweden which meant that they are in control of how much fabric the manufacturers use.

Being involved in every part of the chain meant that quality controls were possible with a limited number of trips to China. Instead materials and samples were sent to the head office for quality controls.

7.6 On Supply Chain Structure and the intermediary

In the previous themes (i.e. chapter 5 and chapter 6) the intermediaries had argued that presence was important for quality and on time delivery and that intermediaries (either internal or external) were the way to solve this dilemma. Looking at these four supply chains and activity charts the differences are striking. The four companies have chosen four very different ways in order to secure quality and on time delivery. The section below looks at these four strategies, first on the supply chain and then on the activities.

7.6.1 The supply chains of the DSGN companies

Looking at the supply chains, DSGN$_4$ and DSGN$_1$ have some interesting similarities. Both companies seem to have a very structured organization for sourcing from China, and although DSGN$_4$ never have had production in-house, they have made sure that they have the technical competence within the
company. Both companies were highly involved in the products in the initial stages; DSGN1 through making their own test samples and DSGN4 through making all patterns in Sweden. Both supply chains were also fairly transparent. In the case of DSGN4, the company was able to view basically the whole supply chain. Whereas DSGN1 did not interact directly with the sub suppliers but leave that up to the suppliers. This transparency makes it easier to take control over the whole supply chain. Both companies were also involved, not only with management and sales representatives, but made the effort to really interact with companies on multiple levels. Here ends the similarities. Whereas DSGN4 did not use intermediaries, DSGN1 had decided to work together with an intermediary, though this intermediary was not supplementing the relationship between DSGN1 and the supplier but enhancing it through actively enabling the transfer of knowledge between the buyer and supplier. The case of DSGN4 also shows that a good relationship does not mean less control. Despite a relationship that dates back to before both the supplier and the buyer had founded their respective companies, DSGN4 has remained in control.

The supply chains of DSGN2 and DSGN3 did not display the same transparency as the two companies mentioned above. Indeed, for DSGN2 the line of visibility ended with the intermediary. Thus these intermediaries that they had chosen to work with were on the one hand blocking their view, making it impossible to trace quality problems or late deliveries, while on the other hand they provided knowledge and competence to DSGN2 of design and technical solutions.

In some ways the downstream activities may be connected to the function of the intermediary. If the products were repackaged in China and sent directly to the retailers in each country this would save time. All of the companies however wanted the products to go to the head office and then to retailers. DSGN2 did not have any retailers but sold all products in their own stores, but for the rest the final quality controls were made as the finished batch reached the storage. Even when discussing a possible subsidiary in China collecting VAT or bundling did not seem to interest DSGN3 at all.

### 7.6.2 Activities of the DSGN companies

If the supply chains displayed the connections between the actors, the activity charts displays division of activities (see figure 7.2, 7.4, 7.6 and 7.8). The activity charts only show the part of the control visible from the focal company, which means that the activities that are beyond the visibility of the focal firm, although performed, are not marked in the charts. The arrows at the bottom show when quality inspections are made and who perform these inspections.

Out of these four companies, DSGN4 (see figure 7.8) shows an example where the focal company has full view of the whole supply chain. The company interacts with every actor in the chain, from manufacturers of fabrics and trims to the full garment manufacturer and transportation from the time the goods
enter the ship. DSGN₄ had organized the company so that all technical competence they need existed within the organization so that they were able to make all designs needed for both trims and garments, to quality control of materials and garments and even to make the patterns. The intermediaries that were used by DSGN₄ were the representatives of the trim and fabric manufacturers in Sweden who provided the company with samples and prices. Thus the contact with the intermediaries allowed DSGN₄ not only to take control over the activities but also to take control over the costs by making sure the manufacturers were purchasing the exact materials and trims and even negotiate the prices. Since the patterns were also made by DSGN₄ there was little room for any flexibility on the part of the manufacturer, but for labour costs and machines. By securing all parts in the supply chain the need for elaborate quality controls during production was kept at its minimum.

If DSGN₄ was a perfect example of control, then DSGN₂ was an example of integration. The sourcing activities were as much as possible integrated with the intermediaries and the design phase took place in China in cooperation with DSGN₂. This part was especially interesting since the other three companies were especially negative towards integrating design. The head designer of one of the companies above said that the Chinese design departments were not able to design products for the northern European market, since our complexions are so different. Despite this negative view on Chinese design the Head Designer admits that once she did find a product that the company bought and that sold very well on the Swedish market. Having a design department at the factory was also perceived as a sign of quality and thus when evaluating a possible new supplier she would look through the designs of that supplier. DSGN₂ was open to design cooperation with the sub suppliers' representatives in Sweden though not with their Chinese suppliers. The overall experience tells them that the Chinese designers cannot design products for the Swedish market which makes it useless even to try to look at the products. DSGN₂ stressed that one of their most important contributions in the design stage was to make sure that the designs fitted the Nordic consumers, sizes as well as complexions. On the other hand, out of all the companies DSGN₂ (see figure 7.4) had the most marginal insight into the activities in the upstream supply chain. Beyond the two intermediaries they have no visibility. The tests that were made on fabrics and trims were all guaranteed by the intermediary though DSGN₂ had the references of other companies that produced their garments in the same factories. The pre production samples were tested in Sweden but during production it was the responsibility of the intermediaries to make sure that the quality was maintained and that the products arrived on time. The intermediary was thus also in control of everything that concerned the suppliers i.e. supplier selection, supplier evaluation, negotiations etc. The negotiations that this intermediary did were not on the part of DSGN₂ however which meant that they in turn had to negotiate prices with the intermediaries, since the payment was hidden.
DSGN₁ and DSGN₃ present two different mid alternatives to the organization of DSGN₂ and DSGN₄. At first glance both companies were involved in direct sourcing, both companies find suppliers, negotiate the prices, and draw the contracts. Without the rigorous control of DSGN₄ these two companies used external intermediaries to ensure quality on location in China. Their approach to these intermediaries are however very different. DSGN₁ took a long-term approach to the intermediary; payments were handled through ensuring a certain amount each month for their services and goal oriented specifications as to what function the intermediary should have (i.e. to represent DSGN₁ on location in China). The intermediary then took control of the production quality making sure that the goods were on board, at the right time, in the right package and having the quality agreed upon. Although there was an agreed upon number of visits that the intermediary of DSGN₁ was supposed to undertake (usually the normal three visits) the intermediary was left to decide if there should be more visits as well as the content of these visits which made them flexible, allowing the intermediary to handle whatever problems that might have occurred. The in-house competence of DSGN₁ also allowed the intermediary to transfer knowledge between buyer and supplier.

DSGN₃ had at the time of the interview a more short-term view on the intermediary and they did not always use intermediaries. They were however the only company that was openly dissatisfied with the organization of the supply chain. The use of temporary intermediaries, paid on a variable commission (i.e. paid for the services that they are contracted to perform), demanded extra work in terms of formalization of what should be incorporated in quality controls. Since the QCs only do the quality checks that are asked for by the buyer who pays for the service and since the quality controllers usually lack the technical competence to go beyond these specifications, the effects of the quality controls are not as efficient as the CEO of DSGN₃ wants. The quality of the quality controls is thus dependent on how good the specifications to the QC intermediary are. Every now and then there are new unwelcome surprises that need to be added for the next specification.

### 7.6.3 On Intermediaries, supply chains and functions

The four cases above, similar in industry and product features, thus show four different ways of using intermediaries. The aspects of these intermediaries and the functions that these intermediaries have are displayed in table 7.1. In the case of DSGN₄ the intermediaries referred to are the intermediaries of trims and fabrics which the company contacts in order to ascertain the quality and with whom they cooperate on design.
Table 7.1 Aspects and functions of the intermediaries used by DSGN$_{1-4}$

<table>
<thead>
<tr>
<th>Relation</th>
<th>Payment</th>
<th>Location</th>
<th>Functions of intermediary</th>
</tr>
</thead>
<tbody>
<tr>
<td>DSGN$_{1}$</td>
<td>Non-exclusive</td>
<td>Buyer</td>
<td>China</td>
</tr>
<tr>
<td></td>
<td>Fixed commission</td>
<td></td>
<td>Check contract</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Quality controls</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Knowledge transfer</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Relationship integration</td>
</tr>
<tr>
<td>DSGN$_{2}$</td>
<td>Exclusive</td>
<td>Independent</td>
<td>China</td>
</tr>
<tr>
<td></td>
<td>Hidden</td>
<td></td>
<td>Design – full garment</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Supplier selection</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Negotiations</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Quality control</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Export documentation</td>
</tr>
<tr>
<td>DSGN$_{3}$</td>
<td>Non-exclusive</td>
<td>Buyer</td>
<td>China</td>
</tr>
<tr>
<td></td>
<td>Variable commission</td>
<td></td>
<td>Quality control</td>
</tr>
<tr>
<td>DSGN$_{4}$</td>
<td>Non-exclusive</td>
<td>Seller</td>
<td>Sweden</td>
</tr>
<tr>
<td></td>
<td>Variable commission</td>
<td></td>
<td>Represent sub suppliers of trims and fabrics</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Design</td>
</tr>
</tbody>
</table>

The value charts and the functions of the intermediaries in table 7.1 display that it is in the production phase above all that the intermediary in China is most valuable. In all cases but for DSGN$_{3}$, the suppliers were responsible for the visits to the factories and it seems to be tricky to make surprise visits from Sweden, especially when you need help to book a hotel and find the manufacturing site. Thus it was in the production phase that two of the direct importers used intermediaries for quality checkups.

All companies buy the products FOB, which means that all documentation concerning the export was handled by the suppliers except in the case of DSGN$_{2}$ where the intermediary takes the responsibility for the products until they are on board the ship.
Theme
In the Middle
8 Intermediaries in China on Functions

The cases in the previous themes discussed internationalisation and functions of the intermediary for Swedish SMEs sourcing form China. In the second theme (chapter 6) the cases described how intermediaries were perceived by the Swedish SMEs as a strategy to cope with quality problems and late deliveries. The third theme (chapter 7) looked more in detail on the activities and functions of the intermediary, which showed that the Swedish SMEs had different views on what activities might be performed by different intermediaries. It also showed that from the perspective of the Swedish SMEs type of payment and degree of formal control (external intermediary or subsidiary) might affect what activities might be performed by the intermediary. Based on this the intermediaries may be divided into three categories of companies; the external long-term intermediaries (in this chapter called Agents), the external short-term intermediaries (here called QC centres) and the subsidiaries (IPO or WFOE). In this chapter the intermediaries in China describe their function and roles in relation to the buyer and the supplier.

8.1 From the perspective of the intermediary

One of the Swedish SMEs that used agents was BTO1. Although the use of intermediaries was more or less necessary when they started to source from China (see chapter 2), BTO1 had continued to use intermediaries for functions such as searching for suppliers, negotiation and monitoring. Quality controls were done in Sweden.

The four cases in chapter 7 used different strategies for their intermediaries. Although sourcing directly, DSGN4 used the subsidiaries of the fabrics and trims suppliers in Sweden to test quality and to cooperate on design. The other three companies either used or was planning to use intermediaries in a long-term perspective in China, though not agents or traders. The main function of the intermediaries in China seemed to be to test quality and monitor production, although the cooperation between DSGN2 and their intermediary involved the whole design process. DSGN3 had from time to time contracted quality control (QC) centres on short-term basis, but seemed dissatisfied with this solution.
What the Swedish SMEs wanted beyond the activities was representation. BTO1 and DSGN1 tried to solve this through contracting intermediaries on a fixed commission. The result differed. The relationship between DSGN1 and their intermediary seemed very successful but BTO1 seemed less satisfied. The solution discussed by both BTO1 and DSGN3 was to start up a subsidiary of their own. This chapter will reflect how the intermediaries in China perceive their role in relation to the buyer and seller and what functions they fulfil.

8.2 The Agents

The three intermediaries in this section represent intermediaries from the three major ports to China – Hong Kong, Taiwan and Shanghai. They are in the same industry; built to order components in metal. All three companies were independent companies, although one (the Taiwanese) worked on commission for the Swedish SME that was their main customer. For this intermediary as well as for the Hong Kong intermediary, trading was a side business to a main occupation. What the intermediaries in this section had in common was that they were all independent external companies on long-term contracts that were involved in the whole process from finding suppliers to organising transportation to Sweden. For simplicity they are all named agents here.

8.2.1 The Hong Kong intermediary – Agent1

Agent1 was actually more of a side business. The respondent was the CEO of a manufacturer of die-casted accessories for high brand leather handbags, but had the intermediary as a side business. The head office of the manufacturer was in Hong Kong but the production facilities were on the mainland, which meant that the respondent during his years as CEO had developed tight relationships with different sub-suppliers and other suppliers of metal components. When China begun its path towards a more open economy in the early 1980s new opportunities emerged for the Hong Kong residents (see chapter 2). The CEO of Agent1, who regularly visited the Hong Kong Trade Fair as well as scanned different popular business sites on the Internet, soon realized that there was an increasing amount of Western companies searching for low price goods from China. Without proper language skills they were however not able to access the smaller manufacturers on the mainland. He also realized that although many of his contacts on the mainland were able to provide the goods asked for by these Western companies, they too lacked the language skills needed to find these buyers. More importantly they also lacked the export license needed to be allowed to export. This created the perfect foundation for a side business. With an export license, adequate English skills and Chinese as native language, the CEO of Agent1 began to answer ads that
presented business opportunities for the companies of friends, relatives or simply business contact on the mainland. He described it as the simple act of grabbing an opportunity to make a good deal. The payment for the services of acting as an agent between the Swedish buyer and the Chinese supplier was added as a percentage on the final sum on the invoice that was sent not from the factory but from Agent1. All contacts between the Swedish buyer and the mainland manufacturers were handled by Agent1.

Despite the fact that the relationship between Agent1 and the Swedish buyer had been continuous for more than 20 years, and from the perspective of the Swedish buyer had been both financially and socially good, the CEO of Agent1 primarily considers the intermediary to be a representative of the suppliers rather than a representative for the Swedish SME. Thus, when the Swedish SME came in with a new request Agent1 would scan his contacts, but not feel obliged to go beyond his established network of contacts on the mainland in order to increase the number of manufacturers on the mainland. Apart from adding a search cost, searching beyond the original network would go against the main purpose which was to exploit opportunities that was presented to him. Although Agent1 regularly took the Swedish buyer on tours to visit the manufacturers these visits were rarely in direct relation to a certain batch in production and more of courtesy calls. In terms of industry, the CEO of Agent1 followed whatever industry his friends had manufacturing capacity to provide a deal in.

8.2.2 The Shanghai intermediary – Agent2

As opposed to the Hong Kong agent, for whom the trading business was just a side business, Agent2 was founded in 2000 by its CEO with the main purpose to help foreign companies to source from China. The Founder of Agent2 had previously worked for a bank, where he had encountered numerous foreign enterprises and became familiar with the problems that these firms experience when sourcing from Chinese suppliers. The primary concern to Agent2 was the comparatively low success rate among foreign SMEs. This low success rate was attributed the small quantities consisting of too many small components that these foreign SMEs were looking for, according to the CEO. This, the CEO argued, led to a catch 22 situation. The Chinese suppliers accessible through the Internet and with sufficient knowledge in English were not interested in producing these types of products in such small quantities. At the same time those who were willing to produce small quantities of complex products were not proficient enough in English to market themselves, not to mention actually negotiating a deal.

At the time of the interview the company had around 40 supplier with whom they were in regular contact. The suppliers were found mainly through regular sources such as Internet directories and exhibitions and were initiated on the specific request from a customer. Most suppliers they had regular
contact with had, however, been found through the personal network of friends. The advantage to suppliers found through friendship was the immediate trust, which meant less control. The contacts with and visits at the suppliers were usually in connection with orders. When a new supplier was tried out, visits were frequent, especially for the first 6 months. Later, visits were limited to the start-up phase of the production of an order. Suppliers that had been used for a longer period were usually not visited in relation to orders but trusted. Trust, the CEO of Agent2 explained, was very important. According to him, no Chinese company would say no to a lucrative deal, but unsolicited orders were not highly regarded among the Chinese suppliers. He felt that too many western companies were just looking for cheap products and had a very short-term perspective on their Sino-foreign business relationship.

All in all, Agent2 gave a very Western impression, with an informative website in English and Chinese, including a business profile. In 2008 the company had about 10 employees, all Chinese, engaged in helping primarily SMEs to source from Chinese suppliers. In terms of geography Agent2 focused mainly on America (primarily the US) and Europe (Britain, Canada, Germany, Greece, India, Italy and Sweden). The focus was due to negative experiences with companies from other parts of the world, that according to the CEO were trying to “steal from China” by not paying for the goods that they had received. On their website Agent2 showed that many of their customers in 2010 were first tier suppliers to large renowned companies in their home country. Agent2 had specialized in hardware and electronic components for industrial and commercial buyers and all invoices were sent from Agent2 with the service fee included.

The CEO of Agent2 had a number of recommendations to companies searching for Chinese suppliers. Firstly, regarding management cooperation, the CEO of Agent2 stressed that it was important to get the right feeling about the management team. When talking to the management team of the suppliers you should feel if the cooperation was going to be a good one. Secondly, the size of the supplier should, according to the CEO of Agent2, match the size of the buying company. Thus, a small buyer should be matched with a small supplier. Thirdly, foreign companies need local expertise to know in what area they should find a supplier. The CEO explained that one of the great advantages of using local intermediaries was that they have a profound knowledge of the geographical area in which you will find the most experienced manufacturers. The clusters were important in order to get high quality products according to the CEO of Agent2.

You don’t buy high quality metal components from a flower area

(CEO of Agent2)

Regarding the possibility that the Western companies that use the services of Agent2 would decide to go directly to the suppliers, the CEO of Agent2 regarded this as part of a quite a normal procedure. The CEO half jokingly
claimed to have a three-year rule: if the buyer was still using their services after three years it was likely that they would continue to do so. A large amount of buyers did however terminate their relationship before the end of these three years, which meant that the company was constantly looking out for new customers.

8.2.3 The Taiwan intermediary – Agent3

In 2003 the CEO of Agent3 was introduced to the CEO of a Swedish SME by a mutual friend. At that time the CEO of Agent3 had her own company that traded consumer products, made in metal and produced with the same production methods as the industrial components bought by the Swedish SME. The man that introduced the two to each other was the manager of a manufacturing company from whom both the CEO of Agent3 and the Swedish SME were buying their products. The Swedish company was however, on the hunt for manufacturers of components that used the same production methods as the mutual manufacturer, although using other raw materials. Thus, thinking that Agent3 might help the Swedish businessman in his hunt for more manufacturers the manufacturer introduced the two.

In the beginning, the Swedish buyer made most of the initial contacts with possible suppliers. Then the contacts were partially handed over to Agent3. At the time of the interview they worked on a contractual basis where the Swedish buyer guaranteed a certain percentage of the CEO’s monthly salary. Invoices and transportation were handled directly between the Swedish buyer and the Taiwanese suppliers, whereas inquiries, negotiations and quality inspections were handled through Agent3. It had also occurred that Agent3 had felt the need to terminate a relationship with a supplier to the Swedish SME when quality demands were not met.

There were about 7-10 suppliers that were contracted on a more or less regular basis by the Swedish SME and the choice of supplier to the Swedish SME came from the fact that they had all specialized in different raw materials. The main problem that Agent3 found with helping Swedish SMEs was quantities. Sometimes the suppliers refuse to take an order because of the small quantities, which adds to the complexity of choosing suppliers for a certain inquiry. Most of the suppliers were fairly small but with English speaking personnel so that they may be accessible to the Swedish buyer.

8.3 The QC centres

This subchapter contains the intermediaries that were not involved in search and selection of suppliers. Since, as mentioned in chapter 6 and 7, the main reason for adding an intermediary after a relationship between buyer and
supplier had already been established was due to quality, these intermediaries are here called QCs which stands for quality control centres. There is a vast number of QC centres all over China today. They provide services listed on their websites in accordance to a price list. A common offer is to visit the supplier of the customers usually three times during a production phase; before production starts, during production and when the products cleared for departure for final inspection. This thesis contains interviews with two separate QC centres; one in Hong Kong and one in Shanghai.

8.3.1 The Hong Kong QC intermediary – QC1

The Founder/CEO of QC1 came to Hong Kong in late 1980s where she landed her first job at the Hong Kong purchasing office of a larger Swedish company. Before she arrived she had studied mandarin Chinese, in Sweden as well as in Taiwan, and in Hong Kong she felt at home and decided to stay. The vision was clear. Trading and working as a link between Sweden and China was what she wanted to use her language skills for.

After fifteen years she decided to leave the purchasing office and start a business of her own. The idea was to concentrate on quality control and to create customized solutions for companies that had decided to outsource their production to China. The main target group was small companies with no local presence in China, and primarily textile and designer goods.

I saw the need to have a Swede that could step in and be prepared to work as a merchandiser as well as a quality controller and who dared to be out in the factories, and step in and work with the production personnel.

(CEO of QC1)

At the time of the interview the CEO was no longer working alone but had one employee working in the office. The companies that QC1 worked with were mostly Swedish SMEs. Some of the customers were absolute beginners, new products that were not yet ready for the market as well as old products in search for cheaper production. Other customers were more experienced companies, who had bought from China for several years but were looking for someone to represent them locally, as they were not interested in starting a subsidiary on their own for some reason or other. For that category of customers, the ones that had already had a working relationship with their manufacturer in China for many years, it was most often quality issues that finally drove them to look for a QC in Hong Kong. When QC1 was contacted the quality problems had usually been going on for a long time.

It was thus not primarily to find and evaluate the first supplier that the idea of an intermediary was proposed, although in time these tasks were sometimes transferred to QC1. The main function was to handle questions that concerned quality, on time delivery, and contacts. The CEO of QC1 preferred to work with long-term quality issues. The industry that QC1 worked in were mostly
seasonal, this meant that the Swedish client arranged for a meeting twice or four times a year depending on the seasons. During this meeting, QC1, the Swedish client and the management of the manufacturer set the guidelines for the upcoming project. New designs, problems encountered and development in general was discussed and documentation was revised. Before each order a plan was set up for at what stage in the production process the quality check-ups should be made and how they should be done. When the order had been sent, QC1 usually got a preview so that they could plan the trips but also to look through the order once more to make sure nothing was unclear. Communication was described as a continuous flow between all three actors.

Usually, there was no contact with the suppliers in between orders, and visits were mostly according to schedule set up by the intermediary. The CEO of QC1 stressed that the company was not “an agent” but an independent quality controller. Payments and contracts (apart from proofreading) was not part of their assignment. The most important advantage of this constellation, according to the CEO of QC1, was being able to go out to the factory and to get to the bottom of an issue, to understand the root of the problem better and to communicate this back to Sweden. The proximity to the factories and her language skills made it possible for the CEO to interact not only with the sales representative of the factory and the management team, but also with the blue collar workers. Often the sales representative of the manufacturer did not have the power or knowledge to discuss the details of a quality issue. When the CEO of QC1 ran into these problems she could call Sweden and ask the customer how they solved the problem when they had production of their own (since many of them had had this). The aim was to bother the management as little as possible and save them for when they were really needed.

Although most of the manufacturers QC1 works with had their head office and management in Hong Kong, the factories were usually on the mainland. The basic understanding of quality and production differed at times between management and factory. Though the management team in Hong Kong might be customer focused, the employees in the factories might never have seen the products that they produce and did not understand the importance of quality. The main challenge, according to the CEO of QC1, was to translate the product to the workers. This meant to teach the workers in the factories how the product was used in Sweden so that they understood the essence of the product specifications and the level of fault tolerance that the Swedish customers had. The CEO of QC1 felt that it was to her advantage to be a Caucasian Chinese speaking woman since it gave her opportunity to actually address problems where the problems were, to go beyond the internal power structures that existed in these manufacturing organizations. QC1 works a lot with companies that either had or had had production in Sweden, which meant that they still possessed a huge amount of technological knowledge on how to produce the products they now source. This was a great support and when out in the factories QC1 was able to handle a situation directly, they could be at the factory
within a couple of hours and when the problem was apparent, QC1 could call the Swedish customer and ask them how they solved similar problems when they produced the goods. This meant that QC1 had to develop and maintain good working relationships, not only to the Chinese suppliers, but also to the Swedish buyer. To do this the CEO found that it was important to go back to Sweden to stay updated on what was happening in Sweden.

In the factories there were different levels of power and different ideas. These power struggles were hard to understand when entering the factory with only the help of translators and manufacturer representatives. The representative was usually a salesman, hired for his proficiency in English and ability to sell, often accompanied by a technician who rarely spoke any English at all. A Caucasian woman that entered the factory floor manifested by her appearance that she was a representative of the Swedish buyer. According to the CEO of QC1 this gave the sales representative, who normally would avoid the factory floor that extra courage to actually try to interfere in quality issues.

Another advantage that came with being a Caucasian woman had turned into a strategic trick for making an initial assessment of a factory. Apart from the tangible ways of assessing a new manufacturer, such as tidiness, references, quality work, how goods were stored etc., QC1 tried to capture the climate of the workers. When walking through the factory of a potential supplier, the CEO of QC1 tried to listen in on the conversations between the factory floor workers. In many parts of this region a Caucasian is still a rare sight, and a cause for funny remarks between workers that assumed that she would not understand what they said. If the workers appeared to have fun, to use jargon when they spoke, then according the CEO of QC1, it was more likely that the climate was open for making positive changes.

Getting a feel for the management team was equally important and the CEO of QC1 usually spent some time in the beginning of the relationship with the suppliers to talk to the management team of the suppliers and to test them with difficult questions to see how they react. The CEO of QC1 had found that the answers to the questions were rather indicative of how the management team might react if there were real problems.

The CEO of QC1 was fluent in Mandarin, not Cantonese as could have been expected considering the area in which they did business, but the CEO actually found her lack of knowledge in Cantonese useful. Many of the workers were migrant workers and thus not fluent in Cantonese either, and the management were often able to speak Mandarin. This meant that in a discussion with the management team Mandarin turned out to be the language that both parties were equally proficient in, which balanced the power somewhat. Especially the older generation found it to be a great relief when they realize that they were able to talk to the CEO of QC1 in Mandarin.

So we start to speak Chinese and it is SO fun. So I have built rather personal relationships with those up there [the people in Mainland China]. They don’t speak perfect mandarin but then again, neither do I. I get invited to eat lunch
over there if I arrive at the right time. So in Hong Kong, which is a rather anonymous and cold city, opportunities have presented themselves due to the language. This has surprised me a lot.

(CEO of QC1)

To end relationships was also a task that needed to be handled, both in regards to customer as well as suppliers. Sometimes it was the Swedish buyer that arrived with unrealistic expectations of what could be sourced in China, or how. It could, for example, be small quantities of specialized and complicated products to an extremely low price. Sometimes it might be that the increased costs of production pushed some of the Swedish buyers to find other suppliers outside China which meant that QC1 became involved not only in terminating the relationship between buyer and supplier but was also involved in the transfer of production from one factory to another was not always effortless. Thus just because the relationship between the buyer and supplier ended it did not always automatically mean that the relationship between QC1 and the Swedish buyer was terminated. Indeed, QC1 had in cooperation with a buyer developed a system to facilitate the transfer of production from one supplier to another without production stop and without affecting the quality. This task of transferring working processes from one factory to another alone justified presence in China, according to the CEO of QC1.

8.3.2 The Shanghai QC intermediary – QC2

As opposed to the companies represented above which were all small companies with less than ten employees, QC2 was part of a large organization with Swedish ownership and management. The organization had Swedish personnel working in China at the office though their task was mainly to keep contact with the Swedish firms in the initial stages, provide market intelligence, find lists of suppliers, organize company visits for groups of Swedish companies and assist the companies that use their office as a nurturing ground for their IPOs. Although many interviews had been made with different representatives within the organization this chapter contains only data from the interview with one Chinese employee (hence called Quality Controller at QC2) who worked in Shanghai and mediated between Swedish SMEs and Chinese suppliers.

According to the Quality Controller at QC2 there were two types of customers that asked for the intermediating services of QC2; the inexperienced company that turned to China in search for cheaper products and the companies that had already sourced from China for some time but who needed help to solve quality issues. The first category of customers usually provided a list of suppliers that they wished to inspect, either by having the employees at QC2 do the inspection themselves or through arranged visits where QC2 assisted in arranging the meetings as well as language and culture advice during
the visits. The problem here according to the Quality Controller at QC2 was that sometimes when the Swedish client had met the supplier at a trade fair or contacted them through a business directory, it might turn out that the contact person in reality was not an employee at the suppliers but an intermediary. Sometimes they were not even an agent working for the supplier but traders that happened to know about the supplier and found it a good opportunity to try to sell their products. At times there were companies that wanted the whole service; to let QC2 find potential suppliers for their products, evaluate them and then come up with a suggestion for what supplier to choose. In these cases the Swedish clients sometimes got too dependent on the services of QC2 and never really managed to develop any contact at all with the Chinese suppliers.

The second type of customers, those who had suppliers but needed help to solve their quality problems were often helped with the assistance of interpretation. A frequent problem was that in order to be able to find good prices for small quantity orders the Swedish companies had turned to small suppliers who had not got sufficient English skills. Even though the sales representative that the Swedish company had had contact with was able to speak very good English he or she were not technically proficient to discuss quality issues while the technical personnel in the factory did not speak any English at all. Still, the quality controllers at QC2 did not interact with the workers in general, but usually only with the sales representatives and management of the suppliers.

The inadequate communication skills were not only on the Chinese side however, according to the Quality Controller at QC2. Some of the Swedish SMEs, especially those with small amount of technical support from the Swedish head office, needed help in writing specifications appropriate for the Chinese supplier. Another issue with the Swedish businessmen was that they were, according to the Quality Controller at QC2, very slow to respond. In China they expected a fast response, meeting one day, quotation the next and then order within two days. Swedish clients sometimes took more than a week to respond. By that time the Chinese supplier had already given up. It had even happened that QC2 had found a supplier but by the time the Swedish company finally made the visit the contact person for the supplier was no longer employed there.

The quality controllers at QC2 did not have any technical background but were employed primarily for their language skills. Though there had been discussions about dividing the quality controller in groups that reflected the industries of their main customers nothing had been done to implement this by the time of the interview. At the moment the work was done on specification from the customer and handed to the quality controller that was available at the time of the inquiry. This meant that for every new project the quality controllers needed to spend extra time reading up on vocabulary and technical terms. This work alone would add an extra two days of work according to the Quality Controller at QC2 since not even the best of dictionaries offered all the
particular word needed to perform a good interpretation. There would always be words not listed in the dictionary or words that had been replaced since the dictionary was printed. Since most of their clients were small to medium sized companies the budgets were usually small and there were usually no room for funding visits for the quality controllers to visit Sweden. Indeed most of the contact between the representative of the Swedish client and QC2 was handled by the Swedish employees whereas the contact with the Chinese suppliers was handled by the Chinese employees. This meant that although the Chinese quality controller met the Swedish client this was mainly in the last stage when they reported on the result of the inquiry or control.

The Quality Controller at QC2 felt that the Swedish SMEs were at great disadvantage in China, mainly due to the smaller volumes. This in combination with their strict requirements and certifications made sourcing in China too complex. The certifications needed for some products were sometimes costly to get, both in terms of money and time, and since both exporter and importer needed certificates the Chinese suppliers found it too costly to apply for certificates if the volumes were small. Some Swedish clients were actually recommended to keep sourcing from Europe instead of China, though the cost of the product might be lower in China, the process as a whole was too costly. The alternative was to turn to trading companies which might be a better solution if the product was technically complicated, or if buying small quantities of cheap, standardized products. Then you did not have to keep storage and was able to buy small quantities but on a frequent basis.

The Quality Controller at QC2 found that although they had some long-term clients, most of the clients chose to find some sort of representation in China if they decided to source on a long-term basis. If the tolerance towards quality issues was low then it was highly recommended by the Quality Controller at QC2 that foreign companies who source in China should employees who represent them in China. The Quality Controller at QC2 recommended that the representative should be a Chinese, due to language and familiarity with the Chinese system and bureaucracy. Even if a company managed to find a westerner that spoke Chinese their proficiency was usually not enough to cope with the negotiations and to be able to read the contracts.

### 8.4 Subsidiary intermediaries

Just as the Quality Controller at QC2 above noted, many Swedish companies choose to establish their own subsidiaries in China. When starting a company in China there are different alternatives, and most companies today choose wholly owned subsidiaries as opposed to the joint ventures that were common before 1994. In the appendix the three alternative forms of companies are explained more in detail. In this section two types of intermediaries are represented. All
three subsidiaries in this section are Wholly Foreign Owned Enterprises (WFOE) which means that they have extended rights to add functions.

8.4.1 IPO/QC… and sales – WFOE₁

As presented in chapter 5.4.2, OM₈ started to source from China when they found out that their largest customer had decided to go beyond them and source directly from China. Chapter 6.4.2 described the journey to an international purchasing office (IPO) situated in an industrial park outside Shanghai.

Thus the main reason why OM₈ decided to start up an international purchasing office was to ensure quality and on time delivery. Apart from the transfer of production knowledge they also realized that buying small volumes from many different suppliers meant higher costs for transportation. They needed a place for bundling. A subsidiary was thus opened to test quality and to bundle orders for transportation to Sweden. Quality tests were made at the subsidiary with machines using software that enabled the head office to read the results of the tests instantly. Apart from email and telephone, Skype meetings were held regularly so that the employees at the head office and subsidiary were able not only to hear each other but also have visual contact. This enabled the personnel at OM₈ and WFOE₁ to actually display the product that they were discussing which had facilitated communication.

At the time of the interview there were five employees as the office in China, all native Chinese. The CEO of WFOE₁ was Swedish and worked at the head office of OM₈. Thus he spent most of his time at the Swedish head office, but spent eight to ten days in China every second month. Apart from the CEO a number of other employees with different competences took turn to visit the WFOE₁ from the head office of OM₈. This meant that there tended to be personnel from Sweden present every month, which meant that when the CEO was not there, an engineer or someone else from the Swedish head office, would be. The idea with a Swedish CEO that travelled back and forth was intended as a temporary solution. The strategy was to have an IPO with Chinese personnel only, including management. One of the reasons for choosing an industrial park with foreign owners was that this would offer the possibility to get help from westerners in case of problems with translation. Despite this and the communication efforts OM₈ feels that the longer they stayed the more convinced they became that they needed a representative from the Swedish office on location permanently. It was not only language and culture barriers that made communication difficult but also the understanding of the product.

The new office improved how they handled the Chinese suppliers. In the beginning they encountered problems such as a new price for the second delivery, when they had expected same products for the same price. Now they felt that there was a stable set of suppliers. Their main problem was still
volumes. WFOE₁ had begun to look for customers on the Chinese market as well. The CEO of the subsidiary meant that in the long run they needed to be self-sufficient and carry their own costs, in order to make the venture stable. Thus the office would serve both as an IPO and a sales office.

OMₖ chose to register a wholly foreign owned subsidiary, despite the fact that they were not actually producing anything in house. Quality control was not considered value adding enough to validate this form company, a representative office would have been enough, so at times they were doing some assembly to at least create the pretence that they had production to keep this status. One of the reasons why they chose to register a WOFE was the export license that made it possible for the company to claim the VAT refund. This option enabled the company to choose smaller companies, that do not have an export license themselves, and since the personnel was Chinese, language and culture was not an obstacle.

8.4.2 Assembly… and sales – WFOE₂

In 2003 the representative office of the parent company of WFOE₂, resided in the facilities of the Swedish Export Council in the centre of Shanghai. The CEO of the subsidiary was a Chinese engineer. Originally from Changchun, the CEO came to Sweden in 1992 as a visiting scholar and worked for ABB robotics in Sweden for three and a half years, before he returned to China, still with ABB, but this time in Shanghai. Thus he was quite familiar with the Swedish market and business life.

First the parent company of WFOE₂ decided to set up a representative office (RepO), which meant that they were not allowed to sign contracts (see the appendix). The main reason for the subsidiary was to sell to the Chinese market. Most of the customers were foreign owned companies or high brand Chinese companies. Originally the products were imported from Sweden. The machines sold by this company were heavy and costly however and in order to be marketable on the Chinese market they had to figure out a way to lower costs. The solution was to import the key component of the machines and then locally source the rest of the components. This solution brought two advantages. First they were able to efficiently protect the patent since no company outside the WFOE₂ had access to blueprints. The second advantage was that if they now wished to export the goods outside China they manipulate the classification that it became as advantageous as possible. The level of the import tax was dependent on what parts were imported and if it was a whole product it meant higher taxes. The classification of the product was thus important when it crossed the Chinese border. There was also a relationship between export and taxes within China. This was due to government policy to support the local market and exports. To navigate the tax system was one part of the job for the subsidiary.
8.4.3 Manufacturing, purchase … and sales – WFOE3

In chapter 5.2.2 and 6.2.2 we met the Swedish manufacturer who, threatened by the possibility of losing one of their products and possibly their largest customer to a Chinese supplier, chose to start up on their own in China. In 2008 the Chinese subsidiary had 16 employees including two Swedish managers (the CEO and the Production Manager).

The time span from decision to first delivery was less than a year. In May 2005, the decision was made and just three months later the Production Manager was contracted and on his way to China. The location was inspired by the CEO and the Production Manager, both with long experience of living and working in China. The location was according to the Production Manager chosen since it was close enough to the big city of Shanghai so that constant blackouts were avoided but far enough to avoid too high salaries.

The first thing that the Production Manager did upon his return to China, was to contract an old Chinese friend as an assistant, whom he had met during his previous stay in China. The assistant had long business experience from buying and selling products and from the insurance industry. Both the Production Manager and the CEO of WFOE3 assured that having a Chinese assistant was absolutely necessary when working in China, for translation both linguistically and culturally. The assistant would accompany the CEO and Production Manager on every visit to supplier as well as customer. In order to find the right suppliers and the right prices Chinese language skills was a must.

The assistant of the Production Manager was also a great help when employing the low skilled workers. The office personnel were usually easier but for the production personnel you had to attend the local employment office. Inside the employment office it was all Chinese. You had to provide the name of the company, how many you wished to hire and for what jobs. This was then projected on the wall, while the employer took a seat and let those who wished to apply come to you and line up. There and then in the office the employer had to assess all the papers and credentials that were shown, which might be an impossible task if you are not familiar with the Chinese schooling system.

Apart from working as an assistant to the Production Manager, the Assistant was also taking care of sub suppliers and sourcing in general for the Chinese subsidiary. The raw material came mainly from foreign owned suppliers since WFOE3 mainly used high quality plastics. The factory was situated in a fairly small town in which the assistant had lived all her life and was well connected and knew who was who.

The factory was situated in an industrial park, and was thus not built from the ground but rented. To rent a factory in China was however quite different from renting a building in Sweden. In China, what you get was four walls and a ceiling. This meant that the first task to handle was to get plumbing and electricity to the facilities. Then came the heating and the cooling, then and the office spaces that had to be built up inside the factory. Despite efforts to make
sure that the conditions in this factory measured up to the conditions in the factory at the head office in Sweden, it was not always possible. The heating was only one thing. In China heating was not related to the temperature outside but to a specific date. Before that date there would be no heating no matter how cold it was.

The subsidiary started up with one product and one customer. Since the reason for the venture was to serve a Swedish customer the first batch was already sold before the facilities in China was contracted. The initial costs of setting up the factory were partially covered by the new contribution margin. The new deal was to make the venture pay off in the long run, which meant that they needed to find customers for the Chinese factory in China. In July 2008, the CEO joined WFOE in order to further support the sales department. They sold mostly to subsidiaries of foreign owned larger companies. Still, the CEO felt that a Chinese assistant was absolutely necessary in order to sell on the Chinese market.

The head office in Sweden and the Chinese subsidiary were producing similar products which meant that at times they were able to cooperate on a new level. If the Swedish parent company had made a deal with a multinational corporation, then they would try to make a deal on the part of the Chinese subsidiary for the Chinese subsidiary of the customer. Likewise, when the Chinese subsidiary managed to land a deal with the subsidiary of a multinational corporation, they would try to pass on the contact to the parent company in Sweden.

8.5 On functions of intermediaries from the China perspective

What is the role of the intermediary? It seems that the respondents have very different views on what their role is. The cases are summarized in table 8.2. The first column shows the type of intermediary using the typology offered by Burt et al. (2003). Though these types of intermediaries are not really applicable (see discussion below). The second column refers to whether the intermediary is internal (I) (i.e. whether it is owned by either buyer or seller) or external (X). The third column refers to location where SH stands for Shanghai, HK for Hong Kong, TW for Taiwan and SHX for the extended area beyond Shanghai which means either Jiangsu or Zhejiang province. The next column shows time perspective i.e whether the intermediary is contracted long-term (LT) or short-term (ST). In the case of Agent2, it could be both which is why this is denoted with a (B). The next column shows type of payment, where the payment for Agent1 is unknown (see chapter 6.2.1), the payment for Agent2 a percentage of the total offer, and Agent3 is paid on a regular bases with a guaranteed sum of money every month.
Table 8.1 The activities of intermediaries in China from the perspective of the intermediary.

<table>
<thead>
<tr>
<th>Name</th>
<th>Type</th>
<th>IX</th>
<th>Loc.</th>
<th>T</th>
<th>Pay</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agent 1</td>
<td>A</td>
<td>X</td>
<td>HK</td>
<td>ST</td>
<td>H</td>
<td>Facilitate contact</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Translate Export lic</td>
</tr>
<tr>
<td>Agent 2</td>
<td>?</td>
<td>X</td>
<td>SH</td>
<td>B</td>
<td>%</td>
<td>Facilitate contact</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Translate Negotiation</td>
</tr>
<tr>
<td>Agent 3</td>
<td>A</td>
<td>X</td>
<td>TW</td>
<td>LT</td>
<td>C</td>
<td>Quality</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Translation Negotiation</td>
</tr>
<tr>
<td>QC 1</td>
<td>?</td>
<td>X</td>
<td>HK</td>
<td>LT</td>
<td>C</td>
<td>Represent buyer</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Facilitate exch</td>
</tr>
<tr>
<td>QC 2</td>
<td>?</td>
<td>X</td>
<td>SH</td>
<td>ST</td>
<td>A</td>
<td>Provide service asked for</td>
</tr>
<tr>
<td>IPO 1</td>
<td>S</td>
<td>I</td>
<td>SHX</td>
<td>LT</td>
<td>VAT</td>
<td>Quality control in-house</td>
</tr>
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<td></td>
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<td></td>
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<td></td>
<td></td>
<td>Assembly Bundling</td>
</tr>
<tr>
<td>WFOE 1</td>
<td>S</td>
<td>I</td>
<td>SH</td>
<td>LT</td>
<td>S</td>
<td>Quality Assembly Sales</td>
</tr>
<tr>
<td>WFOE 2</td>
<td>S</td>
<td>I</td>
<td>SHX</td>
<td>LT</td>
<td>S</td>
<td>Quality Production Sales</td>
</tr>
</tbody>
</table>

As for the QCs the Hong Kong QC has the same payment as Agent 1, whereas QC 2 has the sort of payment that seems to be the most common among QCs namely they have a list of services which are priced. The customer then chooses what services they want and pay accordingly. The final column shows the functions/activities that the intermediaries themselves pronounce as most important which is further discussed below.
8.4.1 On the role of agents

Agent2 defined their role as a bridge between buyer and seller (see figure 8.1). All three constitute what Havila (1996) defines as serial triads where the contact between buyer and seller is limited. Agent1 however clearly perceived himself not as an agent for the buyer but as an agent for his network of suppliers. He provided them with an opportunity to export. Agent2 and Agent3 on the other hand perceived the foreign companies as their main customers for whom they provided their services. Agent2 represented his own company and charged the foreign companies for the services he provided which make him more independent than Agent3 who worked on a contractual basis with a guaranteed minimum wage. Thus the three agents make up for three different types of agents reflecting the findings of Gadde and Snehota (2001), Geersbro (2008) and Ronström (2005) (see figure 7.1). According to the framework set by Gadde and Snehota (2001) and further developed by Geersbro (2008), Agent3 would represent the provider, Agent1 the trader and Agent2 the distributor.

Figure 8.1 The role of the external intermediaries in China part of the whole sourcing process

In a study on three domestic agents, Ronström (2005) find that all three types of agents were moving towards supplying the same set of services, i.e.
assortment, physical possession, promotion, negotiation, financing, risk ing, ordering, payment, handling information and transfer activities (Ronström, 2004). The agents were moving away from the role of match making towards a business model where a triadic business relationships is nurtured (Ronström, 2005). The access to local knowledge in combination with access to network is found to be the central role of the intermediaries in her study. Looking at the agents in this study the network and local knowledge seem to be of essence here as well. The role of these agents are not however to provide assortment, physical possession (none of the agents were involved in handling the goods nor did they have inventory), promotion, financing, risking or even payments since this is mainly done directly from the factories. Instead the main role is to negotiate and to place orders. When it comes to Agent 1 there was no apparent strive to create continuous relationships between the buyer and seller although both buyer and intermediary professed that they had a very close relationship based on many years of doing business together. Bundling, which is often pronounced as a function of the middlemen, was not part of the services provided by these agents. When asked it was stated as impossible, considering that the main products were built-to-order (which meant that other customers were not buying the same products and that volumes and life span were uncertain).

Quality and on time delivery were not mentioned spontaneously and when asked what the intermediaries perceived to be their main role language, culture and communication was listed first. When asked specifically how they view their responsibility in terms of delivering quality and on time the answers referred back to the order statement; we deliver according to specifications. When there was a delay (not when it might be suspected that a delay is prominent) this would be handled in cooperation with the supplier. Quality was thus a question of correcting what had gone wrong rather than a commitment to long-term quality improvements. When asked if they got involved in the work on the factory floor and talked to the blue collar workers they asked me what I mean. How could they do that? What would be the purpose?

8.4.2 On the role of QC centres

Quality and on time delivery were thus not mentioned as a primary role of the intermediaries above by. These were however major concerns for the Swedish SMEs as expressed in chapter 6 and chapter 7. Some of the Swedish SMEs had decided to use quality controllers (QC) to make sure that the goods arrived on time and according to specifications. All in all QC 2 is the type of QC that is described by the Swedish SMEs in chapter 6, i.e. an intermediary that offers a short-term solution of quality control in accordance with specifications from the buyer, and that receives a, usually fixed, amount of money for their services. QC 1 seemed to regard itself as neutral or objective in relation to supplier and buyer (see figure 8.2) but the ties to the suppliers were usually weak. The
suppliers were not part of a network of contacts for the QC and they were only visited when asked by the buyer to do so. During the visit they followed the script they were handed but did little to go beyond this. Indeed the quality controllers at QC1 did not possess any technical competence to do so.

QC2 however operated in a slightly different way. Instead of being a neutral actor, QC2 aimed to act as a representative of the buyer while at the same time actively work to improve the relationship between the buyer and supplier at all levels. Due to QC2’s Swedish background and ability to speak Chinese she was able to interact on all levels in both companies when necessary and thus go beyond the sales representatives and management. This facilitated quality improvements not only in the vision of the management team but also in practice behind the machines on the factory floor. Instead of having a price list, QC2 was paid through a guaranteed sum of money which meant that they could be more flexible to meet the demands of both supplier and buyer. It also put some pressure on QC2 to act beyond the instructions to see what the buyer in Sweden was not able to see from a distance.

![Figure 8.2 The roles of the QC intermediaries in China](image)

8.4.3 On assembly, inventory and manufacturing

Three subsidiaries are represented in this theme; WFOE1 that also handled some repackaging, assembly and above all in-house quality controls, WFOE2 that handled with assembly, sourcing, inventory and sales, and finally WFOE3 that apart from sourcing was a production facility.
The main purpose of WFOE\textsubscript{1} was quality controls. Instead of transporting the goods to storage in Sweden, the final quality test was done in-house in China, using the same equipment that they would have used in Sweden while being able to read the results from the tests on the computers in Sweden. As they were able to repack the goods, they were able to bundle the orders for transportation to Sweden. In this way OMB\textsubscript{8} avoided the additional costs and especially the time consuming efforts of sending defective goods back to China and having new products sent back. This could then be arranged in China so that the products that were put on a ship had the demanded quality. This was the strategy. In reality, OMB\textsubscript{8} has had some problems. The technicians were more than competent to handle the quality checks but were not proficient enough linguistically and did not have enough understanding of the business goals that OMB\textsubscript{8} tried to transfer from Sweden. The Chinese with sufficient language skills were not technically educated and were not able to handle the quality checks. This meant that a year after start-up the technical personnel from Sweden were still travelling back and forth between Sweden and China. Having Chinese personnel may facilitate the bureaucratic dealings described by QC\textsubscript{2} and WFOE\textsubscript{1} and it may facilitate language translations but the need to translate Swedish business culture to China was still needed as mentioned by QC\textsubscript{2}. OMB\textsubscript{8} had tried to overcome this gap, using new technology such as online conference meetings once a week but there was still some distance to overcome.

To set up a subsidiary in China is of course costly and part of the long-term strategy for the venture is that the investment must bear its own costs. Apart from joint ventures (in which case you need a Chinese partner to venture with) there are three different forms of companies available to foreigners – representative office (RepO), foreign-invested commercial enterprise (FICE) and wholly foreign-owned enterprise (WFOE) that all are associated with a certain level of turnover and limitations as to what you are allowed to do (see appendix 2). The costs of setting up the subsidiary also differ. All subsidiaries in this chapter are WFOEs despite the fact that there is no need to open a FICE or a WFOE if you only control quality, which is not considered a value adding activity in China, even if need in-house machines to do the quality tests. The disadvantage of choosing the cheaper investment form of RepO is that the subsidiary is not allowed to sign contracts and not allowed to claim VAT refund. In order to make the investments pay off, however, two of the companies demanded that the intermediaries also sell on the Chinese market (in which case they need to be able to sign contracts) and in the case of WFOE\textsubscript{1} the parent company wished to be able to claim the VAT to fund the investment. Using VAT refund as a way to pay for an investment also meant more bureaucracy and since the suppliers in most cases had calculated on the VAT refund as they set the price they might raise the price accordingly.

Looking at the subsidiaries as triads as we have looked at the other five intermediaries it is noticeable that the subsidiaries here replaced the contact
between the Swedish buyer and the Chinese supplier (see figure 8.3). In the case of WFOE1 this was met by some troubles since the employees were not able to wholly translate the needs of the Swedish buyer. This was solved by frequent travels from the Swedish parent company to the intermediary for support. In the case of WFOE2 the problem was solved by the use of Swedish managers and Chinese assistants that worked closely together.

**Figure 8.3 The role of the subsidiary intermediaries**

### 8.4.4 On the role of the individual

What is the importance of the individual in the intermediary? Looking at what the companies actually discuss in terms of intermediaries they focus more on discussing who than what. First of all there the question of whether the representative should be Western or Chinese. The balance here seems to be connected to technical expertise, language skills, and network but also in the way that their role is interpreted. Those proposing a Western representative usually do so by referring to the understanding of the Swedish customer and market (see for example QC1). This is the knowledge that they want to have
transferred to the Chinese manufacturer. Those who propose a Chinese person refers to the tacit knowledge of how to handle government officials and the network of contacts that make them able to buy from small suppliers at lower costs. As BTO₁ puts it: “in negotiations the Chinese always comes a little further.”

Language skills are also a problem. QC₁ had a mandarin speaking westerner as manager but very few of the western managers positioned in China spoke any Chinese. Westerners without Chinese language skills are still left in the hands of an assistant that follows them around to deal with local government as well as the suppliers. This makes access to the blue-collar workers, as proposed by QC₁, hard to accomplish. The opposite might however also pose a problem. Linguistically gifted engineers are hard to come by and are usually well aware of their price, which means a high salary. This makes them too expensive for the small and medium sized companies to afford which in turn might cause a problem in communication between the intermediary and the Swedish buyer when English skills (sometimes on both sides) are limited.

8.4.5 An extended understanding of intermediary role

Looking back at the typologies of intermediaries offered by previous researchers these are hard to apply to the intermediaries presented above (see figure 8.4). Form of payment and mutual agreement upon what the intermediary should accomplish in combination with finding the right person for the job seem to be more important than the choice between external and internal intermediary. In addition to the seller/independent choices of commission suggested by Burt et al. (2003), buyer is added. Another dimension that might be added is that of how the intermediary relates to the relationship of the buyer and seller. As could be seen above in the case of QC₁ the intermediary took an active role in improving the relationship between the buyer and seller. In this way QC₁ becomes a middle alternative between an external intermediary and an internal subsidiary.

![Figure 8.4 Factors that affect the role of the intermediary](image-url)
Theme
Beyond Dyads
### 9 On the role of intermediaries

One of the interesting aspects of the possibility to come back and meet the same respondents again and again is to see the changes that occur. So far we have looked at the role and functions of intermediaries from the perspective of the individual firm without relating them to each other. Thus, in each case a firm has been able to voice their thoughts on sourcing and the role of the intermediary. In the third theme (chapter 7) the Swedish buyer of four supply chains were interconnected to create a wider perspective on the actions and relationships. These were however snapshots of supply chains at a given time. This chapter looks at one network in particular, that emerges around the focal firm of BTO1. It shows the network at five different points in time, based on interviews with different key informants in 2006, 2007 and 2008. The first two pictures of the network are retrospective. The first interview with the company was made in November 2006, with both the CEO and the Founder. The three last network snapshots are thus done, not in retrospect, but as they presented themselves from the perception of the CEO at the time of the interview.

This chapter also includes some reflections from one of the respondents. Tom is special in the sense that I had the opportunity to interview him three times; in 2006 when he was the CEO of the focal firm BTO1 (which is how he is related to the focal firm), in 2008 when he had worked in China for almost a year as the Purchasing Manager of STDb and then finally in 2009 when he is in his second year as an expatriate in China, still Purchasing Manager for STDb.

#### 9.1 Intermediaries in a network

Are intermediaries a temporary solution? Some of the companies in the previous themes use intermediaries as a temporary solution and some as a long-term solution. The basic assumption underlying both the traders’ dilemma (Ellis, 2005) and the process models (Giunipero and Monczka, 1990; Johanson and Vahlne, 1977; Monczka and Giunipero, 1984; Monczka et al., 2010; Monczka et al., 1998; Monczka and Trent, 1991; Monczka and Trent, 1992; Nassimbeni and Sartor, 2006b) was that through time the know-how of the trade intermediary will pass on to buyer and make the intermediary redundant. One of the companies that were interviewed had been trading with intermediaries since their start-up in the late 1980s. At that time there were few other alternatives but given time – why did they continue to use intermediaries? During the period between 2004 and 2009 the organization of the supply chain of BTO1 changed. Prior to 2004 the organization had been rather static (see chapter 9.2) but then changes started to happen both within the organization...
and in the network. This theme describes these changes and how the role of the intermediaries changed.

Within this supply chain network another story was also embedded. It may be regarded as a sidetrack to the story of the changing network but it was an interesting link to understanding the differences between how the Swedish SMEs perceived the role of the intermediary as opposed to how they were perceived by the intermediaries in China. In 2006, during the first interview with the focal company, Tom was the CEO of BTO1. A couple of months after this interview Tom left the company and moved to China as Purchasing Manager of another company but remained visual from the focal company and stayed in contact with them.

The question that links these two stories together was how do the perception of focal actors (i.e. BTO1 and Tom) of the role of the intermediary in China change through time and with new knowledge/experiences?

9.2 Starting small - prior to 2004

The focal company of this network was BTO1, a small family owned company with 5 employees that produces built-to-order metal components in China for Swedish customers. The products were developed by the customer and much of the development was already finished by the time BTO1 was asked to give a suggestion on price. When BTO1 approached the Chinese market, it was thus rarely with a fixed order but rather an inquiry. High quality was of outmost importance and the volumes were comparatively small and the products had a limited life cycle. Although some products were recurrent, most products were bought only once or irregularly. The material and production processes differed between orders. All in all it was a tough business to build relationships in. For some products with a slightly longer life cycle, BTO1 had storage so that they were able to bring home larger quantities of the products and then send them in smaller batches to the customer. All products were repackaged in Sweden, using the brand of BTO1 and thus disguising which factory the components were produced in, although the products were traceable through internal documents.

9.2.1 The Hong Kong Agent

As mentioned before, BTO1 started to source from China in 1989. According to the Founder of BTO1, the first contact was through a Hong Kong based agent, Agent1 (see figure 9.1). At this point in time Hong Kong was still under British rule and very few small and medium sized manufacturers in Mainland China had the ability to export. The main obstacle was language but the lack of export licenses also created an obstacle for foreign companies that wished to
source in China (see chapter 2). Thus a Hong Kong based agent, proficient in English and western ways of doing business and well connected in business networks in Mainland China presented an excellent solution for BTO1. Travels were confined to one or two trips a year when factories were visited. Otherwise, the Founder of BTO1 felt confident in letting the Hong Kong agent take care of most of the communication and transactions. According to the Founder of BTO1 it was not only a question of language and export licenses, it was also about negotiation power.

We have said that no matter how well we can negotiate, we know that we can never reach to the point where our Chinese partner can. When we think that we have reached as far as one could possibly reach; he [the Hong Kong Agent] will be able to go one step further. It is a matter of communication. We will not be able to go beyond that.

Founder of BTO1

According to Agent1 the first contact happened when he answered an online ad from BTO1. Agent1 was constantly on the lookout for business opportunities and when the ad presented itself he immediately thought about one of his mainland friends who owned a factory that would be suitable for the type of work that BTO1 needed. Since the mainland factory friend did not speak English and did not have an export license, Agent1 saw an opportunity to mediate the deal and collect the VAT for the effort. Throughout the years he had continued to offer his services by mediating between BTO1 and other western buyers and the suppliers in his network of contacts on mainland China.

9.2.2 Turning to Taiwan

During the early 1990s a Swedish customer needed products using sinter; a raw material that none of the suppliers in Agent1’s mainland network was able to supply. According to the Founder of BTO1 it was hard to find manufacturers of high quality sintered goods in Mainland China, so he followed the industry intelligence and started to look for manufacturers in Taiwan instead. Since the material was very important for high quality sintered goods, the Founder decided to use the list of customers handed to him by the supplier of sinter material.

From the list BTO1 chose a number of manufacturer that he visited and among them he selected he found good manufacturers of sintered goods, among these Sinter1. Although the Swedish customers of BTO1 usually made the quality controls of the production sample themselves, BTO1 used a quality controller, who by instruction from BTO1 made quality check-ups at the factories.
Figure 9.1 The BTO₁ supply chain in prior to 2004
9 On the role of intermediaries

9.3 An extended network - 2004

By 2004 the situation had started to change (see figure 9.2). More customers and new products, but the demands of the Swedish customers were still satisfied by the suppliers accessed through the Hong Kong agent and the sinter suppliers in Taiwan.

9.3.1 Trouble in paradise – the Hong Kong Agent

Hong Kong was handed over to China in 1997, but this had not made a great impact on the relationship between the Founder of BTO1, the Hong Kong agent (Agent1) and the suppliers in Mainland China. The downsides to the lack of transparency in the Hong Kong side of the supply chain had begun to show however. Although some of the suppliers now had English-speaking employees and export licenses, all communication was still handled by Agent1. A couple of incidents with failing quality and late deliveries were straining the relationship. The Founder of BTO1 found himself at loss as to what to do. He had met most of the suppliers and when productions were scheduled he tried to call the suppliers to make sure that production had started but the components still failed to arrive on time. One of the problems was that few of the suppliers that were contracted through Agent1 had personnel that were proficient in English. The constant contact did not seem to lead to any radical improvements, and although BTO1 was sympathetic to the situation of the Hong Kong agent, for whom the intermediation was only a side business, it was frustrating for the CEO at BTO1 not to get a grip on where the actual problem was. Was it the suppliers or the intermediary that was the root to these delays?

So we don’t feel that we have the support from there.[from Agent1]. We would like to go directly to the manufacturer, and that is what we are discussing back and forth now. How to get beyond him [Agent1]

Founder of BTO1

9.3.2 A new Agent – The Taiwan suppliers

The number of suppliers in Taiwan had increased, since most suppliers in Taiwan had specialized in type of sinter material. While the Taiwanese manufacturers of sintered goods were still superior in production knowledge to those of the Mainland equivalents, the Taiwanese had come to realize that their prizes were starting to be too high to be competitive. Thus many of the Taiwanese manufacturers had started to move production facilities to the mainland.
Figure 9.2 The BTO₁ supply chain in 2004
We know that when we come to Taiwan, and we go to the sinter suppliers that we source from that they will show their production facilities there, but their main factory is almost always in Mainland China. Almost everyone does that. So what they show us is a place that maybe they think, that we think, that the products are made there, but the machinery is not right.

Founder of BTO₁

Thus things were not as in control as BTO₁ would wish. Pressure from customers to be able to ascertain that ethical production considerations were applied among sub suppliers and an eagerness not to end up in the same situation as they found themselves to be in with the Hong Kong agent; the Founder of BTO₁ decided that it was time to change their sourcing strategy. Sinter₁ suggested that BTO₁ should find a long-term representation in Taiwan and introduced the Founder of BTO₁ to the agent of one of his customers (Agent₃). After some initial meetings Agent₃ agreed to act as an intermediary on contractual basis. The function of Agent₃ in the beginning was to negotiate prices and make initial contact for new projects, but first and foremost to stay in contact with existing suppliers. Although Agent₃ sourced products using the same production techniques as those used for the products that BTO₁ sourced, Agent₃ had no technical background herself (see chapter 8.2.3). This meant that for every new project BTO₁ had to teach Agent₃ the essence of the technical side of the product. Thus Agent₃ had not replaced the role of the QCs but had instead been added for negotiations, continuous contact and translation. The contact with the supplier that suggested Agent₃ remained and was still one of the more important contacts for the company.

9.4 Internal changes and a wider view - 2006

In 2006 the Founder of BTO₁ had decided that it was time for a change. In order to be able to concentrate more on the Swedish customers, he decided it was time for a new CEO to take over.

9.4.1 The new CEO of BTO₁ – Tom is introduced

In January 2006 Tom was appointed new CEO of BTO₁. He brought his old contacts from his previous employments into BTO₁. First of all, in his previous employment as sourcing manager at STD₁, Tom had established contact with a Shanghai agent (Agent₂) who had his own trading company that focused on helping foreign SMEs sourcing in China (see chapter 8.2.2). Agent₂ was now contacted to find suppliers for new projects in Mainland China. At the same time BTO₁ continued to look for suppliers in Mainland China themselves and Agent₃ was also asked to look for suppliers for certain projects thus creating a competition between a larger selection of suppliers.
Figure 9.3 The BTO1 supply chain in 2006
The situation with the Hong Kong agent was still not solved. As far as the prices offered by the new suppliers they matched the price of Agent 1 so new projects were placed elsewhere whereas old projects were kept with existing suppliers and handled by Agent 1. The transfer of tooling in itself would cause losses in both time as well as money. Besides, BTO 1 was not displeased with Agent 1 as a contact, but merely frustrated with the delays that seemed to be unsolvable.

Tom's new position as CEO of BTO 1 also brought new customers. The former employer who was, among other things, a third party logistics (3PL) company, that provided sourcing services, transportation and logistics to some larger Swedish customers, had received an order that was beyond their own contacts in China. Although they were able to provide the product from European suppliers they were curious as to know what price BTO 1 might provide them with. The result was a deal, where STD B, who themselves were sourcing from China, and in possession of a Chinese IPO office, decide to let BTO 1 source a BTO product for one of their long-term customers. The reason was the already established supplier relationships that BTO 1 had with producers of that particular production process.

9.4.2 The Extended role of the Taiwan Agent

Agent 3’s role had also expanded. As the relationship had evolved, Agent 3 had taken over more and more of the tasks involved in BTO 1’s sourcing process. She now actively helped to look for new suppliers and had also taken upon her the task of deciding on what factory not to source from anymore, thus in reality terminating relationships. Above all she had the advantage of being in the same time zone and the flexibility to go out to the factories to talk to management and actually see if the goods were being produced. Quality inspections and evaluations of the factories – other than based on documented quality of delivered goods – still had to be handed over to a QC or handled by the CEO of BTO 1.

9.4.3 Tom on intermediaries and sourcing from China: part I

Tom took the appointment as CEO of BTO 1 with lots of experiences and contacts in China. As the former Purchasing Manager of STD B he had been responsible for the whole process of building up the company’s supply chain in China (see chapter 6.4.3). When the CEO of STD B first suggested that they should start sourcing from China, Tom was hesitant. China in the late 1990s was too far away and communications bad. Chinese companies that were big enough to produce quality and who were able to efficiently communicate were not interested in sending small volumes to Sweden. His suggestion at the time
was to wait with China and build on the existing relationships with European suppliers. 

Three years later as Tom decided to proceed with the plans to source from China it was still in a very precautious manner. He started to travel to some trade fairs, to discuss with other businessmen about their experiences and took it slowly. When Tom felt that STDB was ready to place the first order they did so in cooperation with their German contacts. In this way they managed to increase order volume, and made it more interesting for the Chinese manufacturers to sell to them. They were also able to spread the risk of the venture as a whole. This was perceived as necessary. Even so, they rather quickly ran into problems regarding delivery times and quality.

If they [the Chinese suppliers] received the confirmation that a batch that was expected in week 10, that it was ok to receive the batch in week 20. Then they [the Chinese suppliers] felt that it was no late delivery, but we had still expected the goods in week 10 and the same thing about quality. If the screw fit the nut then there was no problem, but the thing was that this screw might be intended for a completely different application than the one they were thinking of. It just didn’t work out //it was not only a matter of just using the right packaging but to pack suitable for export

Tom, CEO of BTO1

It seemed that the level of tolerance to late deliveries and to deviations from the original specifications were larger among the Chinese suppliers. When the buyer complained they would show that the component worked well in their applications. They seemed to be unable to understand that when the products were delivered to the customer of the buyer the demands would be higher. At the same time the quote indicates that there were implicit knowledge (such as the what packaging is suitable for export) that was not properly written down in the specifications and thus not tended to by the Chinese.

It was hard to come to the root of the problem if you were not fully aware of how they arose. The problems with quality, delivery time and damaged goods in transportation might be attributed to the Chinese suppliers but it might also be the difficulties in communicating expectations to the Chinese. The travels to China were elevated by Tom as necessary when sourcing from China. Without continuous visits it was hard to keep up with what was happening on the Chinese market.

They [other Swedish companies that source in China] don’t have the history that we do. They don’t know what to trust in the communication. The result is not good. Maybe they are just sitting on their butt here in Sweden. Communicating but not travelling there. And even if they do travel they are not able to see beyond the smoke screens that you find there.

Tom, CEO of BTO1

Among the smoke screens that he referred to in this early interview was the insecurity as to whether their contact in China was really employed by the
9 On the role of intermediaries

In this early interview it was not clear if it was really important if they were employed by the supplier or not. When asked about how many suppliers that BTO1 had, the agents were counted as one supplier. In the interview Tom returned to the issue of Chinese business culture several times.

If you are interested how the Chinese think. It is nothing compared to what we are. How they think is a grey zone. In the beginning you were under the impression, based on the tips and advice and ideas from those who had been doing business there [in China] for a long time, that you won’t make friends with the Chinese until you have done business there for 5 years. Then you will become close to him [the contact person in China]. I find that picture distorted. It might take no more than a year and then you were friends to a certain degree.

Tom, CEO of BTO1

Agents were necessary. They were the buffer between the production unit and the customers. They were an aid in communication with the manufacturer since the negotiation phase for built-to-order products usually was lengthy and complex. In reference to such a project Tom made the following statement.

They are a filter between the demands of the manufacturer and the demands from us. They are the buffer in a way. At the same time I would like to say that had we done this [source BTO products] on our own, which I don’t think we actually would have been able to do, it would still be a huge advantage to have somebody over there to help us. We pay for it but I don’t think a Swedish company without experience would have made it. One day it is heaven the next it is hell.

Tom, CEO of BTO1

In the sourcing process of BTO products is usually an lengthy process where discussions regarding what may be altered and what must stay constant in order for the component to be fitted goes back and forth between customer and supplier. Thus it was hard to give a direct answer to possible changes. Negotiations needed to be more of an ongoing discussion than a one-time negotiation on a set specification. Thus the communication back and forth between the Swedish customer, BTO1, the agents and the suppliers was necessary.

When you have a demand from a customer that needs translation to the supplier, here in Sweden this may be resembled to a conversation. If you do it with a supplier in China then there is a counter effect all the time. They make counter demands that this will cost if you see what I mean. They do not have the understanding that this is an ongoing project. They try to protect their business. They will not put the customer in focus in that situation.

Tom, CEO of BTO1

Tom also described this later on in the conversation and referred to situations where the Chinese manufacturers were much tougher in the way they approach
an inquiry. The price that they suggest was based on the specification and any deviation from what was written led to an increase in price. Best scenario that was. Worst scenario - a product that will not meet the demands of the end user.

I really don’t think it is lack of understanding. I really believe that it is a strategic way of doing business from their side. If you don’t explain what you demand from the beginning then don’t come in retrospect and say that it was an implicit need. Why didn’t you just say that from the beginning?

Tom, CEO of BTO\textsubscript{1}

At the time of the interview Tom was the CEO of a small company and as such, considering the small quantities involved, it was not easy to influence manufacturers that were large. Tom felt that due to their size they were not able to just go over to China and start to educate the Chinese. The Chinese suppliers might listen but it was hard to know if it had any impact.

What I have learnt from the Chinese above all is that when you reach a certain point in their competence, where they cannot handle it any more, then all communication ends. Then they don’t want to discuss anymore. They might even change the contact person. It might be that they have promised something and then they are unable to fulfil that promise to 100 per cent. Maybe they need to take a step back. That failure is bigger that you can imagine.

Tom, CEO of BTO\textsubscript{1}

9.5 A new CEO and rapid expansion - 2008

In late spring 2007, Tom decided to return to his former employer, though not to the same position as before but as the new Purchasing Manager in China. At that point in time, China had become the new strategically most important market for STD\textsubscript{B} and thus it had been decided that they should try to develop their relationships with the suppliers in China. Though the contact between Tom and BTO\textsubscript{1} remained as colleagues the project that was started in 2006 had by now been completed. There were still some products in the pipeline for STD\textsubscript{B} but the main idea behind Tom’s new position was that from a position in China he would be able to go beyond the intermediaries, Chinese as well as Swedish.

9.5.1 A new CEO of BTO\textsubscript{1} – the present CEO

About six months after Tom had left his position as CEO of BTO\textsubscript{1} a new CEO took his place. The strategy to fade out the relationships with Agent\textsubscript{1} and Agent\textsubscript{2} remained. The task had proved to be not so easy however. Apart from lacking English speaking personnel it turned out that many of the suppliers that had been contracted through Agent\textsubscript{1} and Agent\textsubscript{2} did not have any export license
which meant that they could not export unless there was an intermediary to handle the documents. Thus BTO1 realizes that they need to find new suppliers with whom they can talk and that were in possession of export licenses.

The new CEO brought a new contact in China, to the relationships of BTO1. Agent4 was an old friend of the new CEO, a Swede, who moved to China some years previously, married a Chinese woman and had started his own trading company. Although using another exclusive agent was against the new strategy they decide to try it out.

A couple of new projects were sent to Agent4 for quotation and the hopes were that in the long run, a Swedish contact in China would allow them to finally get to the bottom with the late deliveries that, although limited, still prevailed. At least a Swedish agent would let them know in advance when products might arrive late.

At a trade fair in Sweden they met Agent5, who had her own company in Sweden. The main business idea of Agent5 was to help small and medium sized Swedish companies to find and evaluate new suppliers in China8, which was exactly what BTO1 needed in addition to their own search for new suppliers. This relationship began to generate direct contacts with Chinese suppliers on the mainland. Thus the function of Agent5 was to find new suppliers and arrange for the visits in China for BTO1. Agent5 did not possess the technical skills to do quality check-ups or evaluate the suppliers in the industry of BTO1. The suppliers that passed the evaluation made by BTO1 and were selected for a sample order was handed over to Agent3, who administrated the day-to-day contact. Agent3, who had taken on more responsibility for the Taiwanese suppliers, and were by then also responsible for these new suppliers situated in Mainland China. Although most contacts concerning payments and transportation remained in the control of BTO1, some Chinese and Taiwanese factories were now sending their invoices through Agent3. Thus this became a period of finding and evaluating new suppliers, as well as trying out new intermediaries.

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8 I have talked to Agent5 over the phone, but most of the information is available at the company home page.
Figure 9.4 The BTO₁ supply chain in 2008
9.5.2 Tom on intermediaries and sourcing from China part II

A year and a half after our first meeting in Sweden, I met Tom again, this time in a small village (which by Chinese measures means almost 1.5 million inhabitants). In the spring of 2007 Tom was offered the job as manager for the IPO of his former employer STDB and this time the timing was right. Tom and his wife moved to China in September 2007 on a 3 year contract.

I really don't remember what I said then [at our last interview]. I am almost prepared to take it all back. It is a little bit different to be here, to live here as opposed to just visit and then go back home. It makes a huge difference.

Tom, Purchasing Manager at STDB

Just before he had left his position as Purchasing Manager in Sweden for STDB, he had suggested that they should start up an IPO. The reason was that if they had the intention to increase purchases from China, they needed to be able to source locally, to the large trade fairs and find medium sized suppliers that were capable to produce high quality goods to a low price. Together with Chinese speaking personnel they would be able to get in contact with companies that were able to meet their quality demands but who did not have English speaking sales personnel. As the CEO of the parent company gave his consent to start an IPO, he did so, on the condition that the IPO must also be able to pay off through sales on the Chinese market. In March 2008, there were 7 employees at the IPO, apart from Tom, all Chinese. To have one western manager focusing on both sales and sourcing had not worked out well, so Tom was assigned to focus on sourcing while a new employee were on its way to handle the sales. In the small town there were some 500 foreigners, that worked for different foreign companies but they were spread all over the town.

STDB had decided that they should try to limit their use of agents when sourcing in China, though there were exceptions. For one specific customer, where quantities were large and whom they had supplied for many years using a specific manufacturer that came through the contact of an agent they had decided to keep things as they were. Despite presence in China, despite Chinese speaking employees, despite access to the manufacturer, STDB still bought through the agent. To avoid agents were tricky but much easier now that they had their own representation in China. A few weeks before we met Tom had been contacted by e-mail by a person who claimed to represent a manufacturer in Hangzhou. The mail was sent to the Swedish e-mail address. The offer was interesting but the name of the company was strange, giving no indication that it was a manufacturing company. Still it sparked Tom’s curiosity so he contacted the company through his Swedish cell phone, which meant that the contact person were not able to see that he was really calling from China. They decided that he should pay a visit but did not agree on a specific time nor did he tell the contact person that he was really living in China.
Then a week or a couple of days went by and I called up and told her my name and so on. Good, you recognize me and I told her I live in [YY], can I come and visit next week and then it was quiet. Ok that will be fine but call me before you go so that you know where it is.

Tom, Purchasing Manager at STDB

At the same time the chairman of the board for the Swedish parent company had contacted Tom, and urged him to visit the contact of an acquaintance in the same region as the company for which this woman claimed to work. The matter had been raised some months before but for some reason or other Tom had postponed the visit. Now he felt that it was time but on his way to the factory he called up the woman referred to above again, thinking that he might as well visit both the factories. When they called the contact woman, she claimed that she was in Shanghai and were not able to meet them at the factory, but was willing to give Tom and his Chinese assistant the address and direct telephone number to the factory. The strange thing was that the address and telephone number was the same as the one that they were already on their way to visit.

At the factory they showed the name and number to the sales representative and the manager and asked them if they knew who she was. The manager of the supplier was surprised; he did not know who she was. It turned out that although she had made pretences to be the spokesman for this manufacturer, showed the prices lists and the product assortment, in reality she had nothing to do with the company in any other way than that she was able to buy from the company and resell to people like Tom, or rather people like Tom living in Sweden. These types of intermediaries were the ones that Tom was now trying to get rid of, intermediaries that were almost impossible to discover from Sweden. When the delegation from Sweden arrived, everything had already been arranged by the intermediary. The manufacturer did not really seem to care if there was a person proficient in English making false claims to be a sales representative if it could lead to business.

Accessing the suppliers however meant negotiations in Chinese. Tom always brought his Chinese assistant with him. Among the suppliers half was very proficient in English but the other half spoke Chinese only.

It depends on what type of company you wish to do business with. If it is a company that exports then there will be an export license and foreign language speaking personnel. If it is a company that only sells on the domestic market then there is no need for an export license and that is where [the agent] comes in He represents the companies that only have the domestic market.

Tom, Purchasing Manager at STDB

The IPO was registered as a representative office. This meant that they cannot sign contracts nor claim the VAT, an agent was needed lest the manufacturer themselves had an export license. Being a small importer in a global context also means that they had to battle for prices.
9 On the role of intermediaries

If I ask for 10,000 pieces of an article then they will say no. The lowest quantity in order for us [the supplier] to produce is 100,000. It is a reversed bidding so to speak. If you are to buy this article then you have to buy 100,000 and we might not know this from the beginning.

Tom, Purchasing Manager at STD

Then again, often it was just a matter of price. Small quantities meant a higher price per piece. The difference might be significant. During his stay in China, Tom had come to realize that part of the problem may be traced to the manufacturers own purchases. The quantities in which a certain material was bought and how it was handled in the production. This meant that finding a fair price to a certain quantity and a certain quality was hard. This had become an important role for the IPO.

In the end everybody can give a price but you have to understand the market price as well. That is where my role comes in. I don’t think it is a question of lower or higher [price]. It is about the supplier not understanding the message and the [quality] demands on that product. //You read their offer and then you understand that they have got it wrong. Many times the price could be much, much too low and then you call them up just to check [if they have really understood the specifications].

Tom, Purchasing Manager at STD

Being in China had given Tom a sense of understanding of what the products at a certain quality should cost and thus immediately see if the price in the offer was reasonable. If the price in the offer was too high, the offer will be discarded or renegotiated. If the offer is too low, it is likely that something is wrong, which means that this has to be altered before production starts.

Visits to factories with which they had orders in production were regular, once a month or once every fourth month for those that they had known for a long time. The same frequency of visits with local suppliers that was possible in Sweden had not been transferred to China. The distances between the factories were too large. When in Sweden, they had discussed Chinese manufacturers the distances had seemed so close, but living in China Tom had come to realize just how long time it took to move from one facility to another.

It is rare to do courtesy calls [in China]. You rarely have the time. It is not as in Småland where you stop by for a cup of coffee. It doesn’t work that way here. Although I try to do it here in [town] I usually stop by to say hello, how are you, is everything fine. Then you get a cup of tea. Do some small talk. Half an hour passes. Then you have the social part. Then you talk experiences, talk about prices. Talk about new products that are on its way and so on.

Tom, Purchasing Manager at STD

Tom thus felt that living in China had made him more receptive to what was happening on the Chinese market, to be able to assess what a reasonable price was and to see beyond those who give false pretences of representing manufacturers. At the same time, living in China was not a walk in the park.
Tom had started to take lessons in Chinese but found it hard to find time to study.

It is not so easy to be here. It is a huge difference to what I had imagined. Everything takes longer time. Tickets. Whatever you want to do it takes time. Back home in Sweden, you know how it works. It doesn’t have to be so hard to buy a train ticket when you know where to go, if you had a queue waiting in front of you. If we want to buy train tickets here then there might be a two-hour line in front of us. We have found a ticket office where there rarely is any line at all now. These are the things you learn when you are here. There is a line everywhere. There is a queue in the food store. One for bank errands // I am not used to it. Everything takes such a long time //It is heaps of documents to keep track of.

Tom, Purchasing Manager at STDₙ

Patience was something that you learnt in China as well as finding loopholes. Just as the incident with the ticket office in the quote above, there was a need to find a way to pass the “dents in the road” as Tom called them. To find them was not always easy however. Tom referred to an incident where he wanted to open a bank account but was denied. It took a long time before he finally asked the right question and was able to understand that there was a document missing. All in all, living in China had turned out to be a whole new experience and had in many ways altered Tom’s perception of the intermediaries in China and the role of the subsidiary.

9.6 Towards stability and control - 2009

A year later, the plans that were already boiling beneath the surface of the rapid change the previous year had started to take form. In 2008 the European Union decided to impose 70 per cent antidumping duties on all fasteners after a long investigation asked for by steel manufacturers in Europe that claimed that China was dumping the prices on metal goods and fasteners in particular. This had forced all importers of metal goods to look over their sourcing strategy. For BTO₁, the effect of these duties had not been so hard as it had been for STDₙ.

9.6.1 Reducing the number of Agents

In 2009 BTO₁ were still continuing with their plan to fade out Agent₁ and Agent₂ slowly. Their services were still kept for the products that were under production but BTO₁ avoided placing new projects with either of the agents if possible. Sinter₁ in Taiwan was still used as a supplier as much as possible.

Agent₄ and Agent₅ were no longer working for BTO₁. The work of Agent₅ had left BTO₁ with an abundance of new suppliers in the region outside
Shanghai. The number of new suppliers were so many that BTO1 had found it to be inevitable to terminate the contract with Agent5.

She [Agent5] has done such a good job, but she really made herself redundant. The concept that she presents//she has found so many contacts. We don’t have the capacity to handle all of them and that is not a goal in itself to have that [as many contacts as possible]. The last assignment that we gave her was to find as many suppliers in the [Zhejiang] region as possible. We already have [Agent3] who is bilingual, and who is paid [on a contractual basis] within the organization.

The co-Founder/assistant CEO of BTO1

Without complementary skills to those of Agent3, except for capacity of finding new suppliers, Agent5 had become redundant. Agent5 did not have the technical skills to make quality and production checkups, and although the trip between China and Sweden was almost as easy to make as the trip from Taiwan to Shanghai, Agent5 was still in the same time zone, thus awake when things were happening.

Agent5 was also not part of the plan any longer. The CEO of BTO1 suspected that he had grown impatient with the low outcome of the inquiries. BTO1 estimates that for every inquiry that they received and sent to China only one out of ten lead to an order. Thus for one agent out of several agents in the supply chain the number was even lower. This meant that a lot of the work that was done did not pay off. Besides, the prices that this agent found were higher than the other bids which meant that his share was rather low.

When the CEO of BTO1 counted aloud to answer the question concerning how many suppliers that were now engaged, Agent1 and Agent2 were counted as one supplier although in reality they were intermediaries to many manufacturers. Was it hard to know who was a trader and who was a representative of a manufacturer?

The one that delivers the product is responsible for the whole product. Then it differs depending on the product. Some are, though you might not know it, traders. Sometimes it is hard to tell the difference//some sub suppliers are traders too. If it works then we don’t mind. We don’t have any opinions on that. It really doesn’t matter, that is the way the system works in China.

The CEO of BTO1

By “the system in China” they referred to the system of VAT refund and export licenses that were usually collected by the traders as part of their commission. A meeting with a representative from an industrial park in China has opened their eyes to the system of VAT and export licenses and pawed the way for new strategies.
Figure 9.5 The BTO₁ supply chain in 2009
9.6.2 The new strategy

The new strategy was to start up an office in China, a joint venture between Agent3 in Taiwan and BTO1 in Sweden. During the spring BTO1 had been informed about how the VAT refund system works in China. The plan was to finance the new venture through the VAT refund and thus to finally be able to go beyond the traders and agents. The VAT refund was of course not the only reason.

Quality is the primary reason. This [the VAT refund] is just the icing on the cake. Quality and proximity are the most important things. The frequency in visits The ability to be close when something is happening. The distance is a problem

CEO of BTO1

Agent3’s role was thus about to change again. The idea from the perspective of BTO1 was that Agent3 would take the primary responsibility for the representative in China. Again, being in the same time zone would render her the advantage of the same office hours. The employee that they had begun to search for, as a representative in China, was a Chinese engineer with production knowledge and some language skills. They had been in contact with another SME in the region who had advised them to go for technical skills above language skills. Those who were good at English would move on to another company faster. Apart from lowering the prices and replace the QC that was still used from time to time, the expectations were that they would be able to find new customers on an international arena that would help the investment pay off.

Engineers are good at designing. That is what they are trained to do. On the other hand they are not necessarily good at producing. This is where we [BTO1] have some value to add.

CEO of BTO1

The new representative was also expected to handle the bureaucracy in China and Chinese governmental officials. The location was chosen based on the existing connections between Scandinavian firms and local government. At the time of the interview the office was still in the planning phase but since all deliveries passed the head office in Sweden for a final quality inspection, repackaging and storage, the thought of doing the same in China had occurred. The effect would be that they might be able to bundle different orders into one transport. In the past there had been occasions when they had collected different components from different suppliers, to assembly at another facility. With an office in China they would like to keep the opportunity open to be able to assembly at the new Chinese office as well. The main advantage of being on location was to be able to be close to the suppliers.
The dripping water method. Establish contact. They [the suppliers] will understand that there are no short cuts and he [the representative in China] will come closer to the truth in a way that we don’t. Now they tell us that they have almost finished when they haven’t even started.

CEO of BTO₁

By this time BTO₁ had realized that usually it was not the main supplier that was the problem, but their sub suppliers and usually they did not have any English speaking personnel which made it hard for BTO₁ to communicate efficiently with them. The new strategy would of course lead to other changes within the supply chain. One of the new suppliers that Agent₅ had introduced was actually a Shanghai born trader. Though quite new, he had proved to be open-minded and easy to communicate with. The first delivery was excellent and the price was right.

Of course the future does not look bright for a guy like him. If we are established there then we will be able to do what he does and of course he makes some kind of profit in between and that is the profit we want.

The co-Founder/assistant CEO of BTO₁

9.6.3 Tom on intermediaries and sourcing from China part III

I met Tom in the lobby of a hotel in Shanghai, a year had passed since our last meeting. During this time he and his wife had moved from the small town to the eastern metropolis we met in. He had fallen behind in the Chinese language course, partly due to the move and partly due to other changes in the market which had suddenly brought his presence in China up for discussion and increased the numbers of hours spent on travelling. The business contact with Agent₂ had faded out, and what remained was a good personal relationship.

For Tom and STD₈ the debate between European Union and China had profoundly altered the situation for Tom. As a consequence of the anti-dumping duties that were the result of the EU investigation in combination with the recession in the world market, China was no longer the most prioritized sourcing market for STD₈, which at first had caused Tom to doubt his position in China. Tom was very critical towards how this investigation had been done as well as the result.
What they compared was the price of an article for export and the cost if you buy it so to speak directly at the manufacturer at the local market. When the large retailers in Europe, the ones that buy in large quantities, buy in China, they buy containers and then you get a rather good price. But if you buy directly from the manufacturer here in China, they buy what they need at the moment, not more. So if you buy let's say 500,000 fasteners to get a good price, he might need 80,000; then the price will be accordingly and he will have to pay much, much more so if you compare the average price on the local market the picture will be distorted.

Tom, Purchasing Manager at STD_B

Despite his critique to the investigation, Tom admitted that there were other factors that affected the huge price difference that was displayed by the investigation. The Chinese government had for a long time subsidized export through VAT refunds (the percentage differed between industries but for metal industry was somewhere between 5-11 per cent) but after the investigation the percentage had dropped. All together this led to a very sharp peak in the prices of fasteners and metal goods produced in China. Since the first shock of the EU decision had cooled down the prices in China had begun to fall back a little. There were rumours that those who were interviewed by the EU investigators had been warned and that they had adjusted the prices that they handed over to the investigators. On the other hand, it became very hard for the buyers to see what part of the price increase was a justified and what was an attempt among the suppliers to increase their contribution margin.

We saw that our suppliers tried to do, and when one tries they all try to follow along, so it was very hard to tell the difference on what was the real raise and what was part of a forced raise, so to speak.

Tom, Purchasing Manager at STD_B

Thus the situation had changed dramatically in every sense for the IPO. In May 2009, STD_B had moved most of the production away from China, primarily to Taiwan, Malaysia and India, but above all, back to Europe. The prices in Europe had dropped dramatically. To buy from Europe was advantageous, especially if the manufacturer had his own storage, which meant that they were able to buy small quantities often. And when the price difference was small it paid off.

Although no more than 5 per cent of STD_B’s production was left in China (together with the rest of Asia the equivalent number was 10-15 per cent), and despite the good relationships that Tom had built up with their European suppliers around the turn of the millennium, Tom still did not feel that the European manufacturers were the future, especially not when it came to the low price segment of fasteners. The contribution margin for the manufacturers in Europe was very low, especially for those with their own storage.

They have a very short-term view on making money // in Europe, I mean, Often if you belong to a larger group of companies or the like then it is just a
year at the time or something like that. If you take private entrepreneurs in Sweden then they have a little longer time span. Many of the companies here in China are private entrepreneurs. They have a completely different view on expected return on investment and things like that. Here there is an unprecedented will to contribute to something good. // might move from region to region here but it will remain here for many years. There is no other country or part of the world that is prepared to take over this [i.e. the low price segment of fasteners]

Tom, Purchasing Manager at STDB

Despite his long hesitation towards China and belief in the European market at the end of the nineteenth century, Tom now felt confident that China would rise above the current setback. On a short-term basis the situation had led to an increased amount of travels for Tom.

Previously, Tom’s main task in China had been to find and evaluate new suppliers in China, while also maintaining existing relationships, placing orders, do quality controls on products in production etc. Fewer orders were now placed with the Chinese manufacturers, which meant that some relationships were cooling off. Having the advantage of relative closeness and being in almost the same time zone, Tom was now assigned to find and evaluate suppliers outside China, in other Asian countries. Partially this was done the traditional way, through trade fairs and online directories, but wise from his former experiences, Tom also use existing contacts for this purpose. The Chinese suppliers, acutely aware of their own position, had begun to start up new factories in countries such as Malaysia and Vietnam. Thus, through the existing relationships with Chinese suppliers he was now invited to follow them on their venture to offshore their production.

Many Chinese manufacturers affected by these anti-dumping duties are starting to move their production to Indonesia and to Malaysia. So I will go down there to have a look and then, when it comes to Vietnam, there is an invitation from a supplier that has a subsidiary there that we are going to visit and then they have promised to help me to look for other [suppliers] there. There are still not so many [metal component suppliers] there yet. It is still very new.

Tom, Purchasing Manager at STDB

Instead of breaking off with the Chinese suppliers Tom was now following them, finding new solutions in cooperation with them. At the same time Tom saw a risk in this. At one point in our discussion he used the expression “now that we had this problem that we no longer can export from China” instead of manufacture in China, which might disclose a certain difference. If there was a heavy increase in goods arriving from other parts of Asia such as Malaysia and Vietnam, the European Union might decide to stretch the anti-dumping duties to include goods coming from other countries in Asia as well.

9 This turned out to be partly true. In 2008, directly after the anti-dumping duties were introduced, China filed a complaint to WTO, who actually ruled in China’s
The relationships with the suppliers in China had somewhat changed character since Tom decided to move to China.

I had a rather good contact with my suppliers in Europe and Sweden before. Both privately and professionally. Here it takes a while before you get to know each other but that is what I feel I have now been able to do. In Europe you can talk about social things and quickly you find you have a common interest. You don't find that particularly often in China directly, you are tiptoeing a bit.

Tom, Purchasing Manager at STD₉

The relationships that were described as close before, he now realized had another dimension due to his long stay in China. The visits before were often hectic, based on quantity. How many factories and visits may be summoned in a week or two? Now there was time for reflection and for finding out what were sensitive subjects to talk about and what subjects were suitable for a first encounter.

It also has much to do about who you are as a person, if you seek contact you will get contact. If you seek information you will get information. So what I mean is that I am probably a “relationship buyer” who wants both. I want the information about the product. I want the information about the company. I want the information about the person standing behind the company. I feel that it gives me the large picture of how the company is built and how the person behind the company handles the company.

Tom, Purchasing Manager at STD₉

Tom also pointed out that at the same time the Chinese had been affected by the increased contact with Westerners, since more Westerners came to China to do business while at the same time more and more Chinese took the opportunities to go to Sweden.

I know a contact, he travels abroad four or five times a year. To Canada, to the US, Australia and so on and of course they [the Chinese] will have a different view on how things work outside China faster than I think anyone could imagine.

Tom, Purchasing Manager at STD₉

Tom feels that the role of the IPO had changed during his time in China. More and more responsibility for the quality was pushed towards the suppliers. When he talked about the suppliers, he talked mainly about the manufacturers that were constantly supplying STD₉ with products. These suppliers were now taking over more control over the final product. The communication in the pre-order stage was also commented on. When an inquiry was handed to a manufacturer they would return it with comments on production procedures favour. Still the European Union, after some adjustments to the original decision, decided to stretch their anti-dumping duties to include, among others, Malaysia.
and materials if they felt that cost savings were possible. These were in turn commented on by the end customer in Sweden.

That [part of the cooperation] works much better now that we are represented here // then you can tell the supplier when you visit him that we want you to manufacture this as cheaply as possible so if there is anything that you feel could be improved on here, at this stage of the inquiry then I want you to voice those ideas. That is something we really want to encourage.

Tom, Purchasing Manager at STD

Language was however still a barrier in this type of communication. Tom points out that although many of the representatives were very good technicians they still had problems expressing themselves in English, verbally and in writing. This meant that Tom still needed a technician, proficient in English, to accompany him when he visited the suppliers. Access was the main difference between working as a purchasing manager in Sweden sourcing in China as opposed to being a purchasing manager in China. When you could call a supplier and was able to be there within an hour it made a lot of difference. This had also affected Tom’s view on his role in relation to the suppliers and the head office.

Instead of you waiting for something [to happen] you are part of the process from the beginning. So I am really a part of the supplier. The prolonged arm of the supplier here [in China].

Tom, Purchasing Manager at STD

The big question was of course whether having a Swedish employee had paid off for the company. Although that was a question impossible to answer in definite terms, Tom did not believe that he was more expensive in China than he had been as an employee at the head office in Sweden, even with all the travels, payroll taxes etc. taken into consideration. Especially not in relation to what he and his predecessor had accomplished in four years.

When I arrived there were of course shortcomings in terms of service level that is not so much in quality but above all in service. The wrong product at the wrong time. Things like that I have now managed to solve.// I am surprised actually that so few companies in Sweden chose to do this because you can, provided that you have the support from home and the will to make changes, do tremendous progress here short-term and in a short period of time

Tom, Purchasing Manager at STD

Tom thought that the reason why so many companies still refrained from starting an IPO in China despite their purchases was a combination of many things. Uncertainty of the life span of a product, fear of knowledge transfer and transfer of jobs were among the reasons that Tom voiced. So, whom should they chose, a Chinese or a Swede, as the head of the IPO? The answer came quickly. A Swede. Although he was very open to the idea to have a Chinese CEO and then Swedish purchasing, production or sales manager, the felt that a
Swedish representative was absolutely necessary. His reasons were basically the connection to the head office and the employees over there. Tom felt that the commitments and responsibility that those who were sent out from the head office felt towards the colleges and friends at home as well as their ability to understand what was happening at the home office through informal channels as well as knowing who to contact concerning what question, was a great strength.

9.7 On evolving roles and perception of roles

The snapshot pictures of the evolving business relationships above show how the horizon of BTO1 expands and contract through time. As time passes the roles change between the different actors. The pictures are all drawn from the perspective of BTO1, who considers themselves to be the channel designer. Had the focal firm been another actor in the network – such as Agent1 or STD1, the picture would of course be quite different. Indeed, by the definition of the word, BTO1 is of course also an intermediary. Apart from being in between the customers and the suppliers they produce nothing themselves. They have no product development in the sense that they find new products to market. How do they define their function as an intermediary? Thus, from the perspective of BTO1 who is an intermediary and what value do they bring to the customers?

9.7.1 Intermediary as an evolving strategy

The figures (9.1-9.5) show how the relationships in the network emerge and disappear through time. As time passes the companies try to figure out how to manage the roles in between them in relation to each other (see table 9.1). In the beginning, as knowledge about the Chinese market was limited at BTO1, the use of agents with exclusive networks was satisfying. In the early phase BTO1 felt that there were no real alternatives given their size, limited knowledge and the maturity of the Chinese market in the late 1980s and the strategy worked well enough for one and a half decade. By this time BTO1 had expanded their experience not only through Agent1 whom they felt comfortable with but also through their direct sourcing activities on the Taiwanese market. It is interesting to note that it is the Taiwanese producer who suggests that they find a permanent quality controller to handle the suppliers in Taiwan, thus enforcing their conviction that presence on the Chinese market is important for the company.
By 2006 however, the lack of transparency in the networks of Agent\textsubscript{1} and Agent\textsubscript{2} has grown into a problem for BTO\textsubscript{1}. Since they are unable to address the suppliers regarding the late deliveries they try to solve the problems with the agents but no improvements appear. Going beyond the agents is more or less impossible since the network of suppliers mainly consists of small manufacturers with little or no English speaking personnel and in some cases without an export license. This forms the new strategy that is based on open and transparent network of suppliers aided by intermediaries in China for quality control.

They make one more try, however. Through the contacts of the new CEO in 2007 they find a Swedish agent located in China who although not willing to let the network be open at least notifies in time when products are running late. This relationship falls out rather quickly however due to the low number of long-term orders.

The second solution is Agent\textsubscript{3} who is assigned to locate and contact suppliers with export licenses and English speaking personnel. The cooperation is very successful. Too successful, since the relationship has to be terminated when the number of suppliers reaches a level where BTO\textsubscript{1} is no longer able to handle any more.

The relationship with Agent\textsubscript{3} also begins to evolve into a new direction when BTO\textsubscript{1} realized that they were able to collect the VAT if they invested in China. Together with Agent\textsubscript{3} they decided to start a joint venture with one employee in China that would handle the relationships with the new suppliers.

Thus although BTO\textsubscript{1} uses an intermediated sourcing strategy throughout the whole period there are several different intermediated strategies with very different structures in the roles that the intermediary in China and in Sweden uphold. Indeed BTO\textsubscript{1} and STD\textsubscript{2} may also be termed intermediaries to their customers. Why would a company with their an IPO in China choose to source through a Swedish intermediary such as BTO\textsubscript{1}? The suppliers of STD\textsubscript{2} in China are mainly focusing on standardized products for Swedish customers who wish to buy the products in small batches more frequently. Thus their main contribution to their customers is that they are able to buy larger quantities in China and then store them in Sweden and divide the batches between many customers. When faced with a new sourcing dilemma; to find a small batch of special BTO components they turned to a Swedish intermediary (and of course to a well known contact) that had the right type of network in China to handle this type of order. Thus between the Swedish agents the roles were very different.
9 On the role of intermediaries

Table 9.1 The different roles of the different intermediaries in BTO₁’s supply chain

<table>
<thead>
<tr>
<th></th>
<th>Relation</th>
<th>Payment</th>
<th>Location</th>
<th>Nationality</th>
<th>Functions of intermediary</th>
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</thead>
<tbody>
<tr>
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<td>Hidden</td>
<td>Sell</td>
<td>China</td>
<td>Chinese</td>
</tr>
<tr>
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<td>Exclusive</td>
<td>Hidden</td>
<td>Ind</td>
<td>China</td>
<td>Chinese</td>
</tr>
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<td>Fixed comm</td>
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<td>Chinese/Taiwanese</td>
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<td>Exclusive</td>
<td>Hidden</td>
<td>Ind</td>
<td>Swe</td>
<td>Swedish</td>
</tr>
</tbody>
</table>

9.7.2 Intermediary as an evolving role – Agent₃

During the years that are displayed in the five snapshots of the network the role of Agent₃ from the perspective of the focal actor, BTO₁, changes dramatically (see table9.2). In 2004 as first contact was made, the initial role was that of quality controller interpreter, travel agency and above all making sure that the products were in production on time. The payment was settled as a guaranteed monthly payment regardless whether any products were in production or not. Very quickly new tasks were transferred to Agent₃. BTO₁ realized that the
negotiation power of Agent 3 was stronger than theirs and once this task had been transferred others followed. Soon Agent 3 had taken over all activities regarding the purchase based on the inquiries sent from Sweden. The network of suppliers was completely transparent however and although Agent 3 might give suggestions as to what supplier would be most appropriate, BTO 1 made the final decision. As time went by Agent 3 also started to give suggestions of new suppliers as well as recommending the termination of relationships with suppliers. Although the final decision always rested with BTO 1 they were often inclined to follow the recommendations. In 2008 as BTO 1 had started to find new suppliers in Mainland China, the services of Agent 3 was also extended to incorporate contact with these suppliers in Mainland China.

Table 9.2 The evolving role of Agent 3

<table>
<thead>
<tr>
<th>Year</th>
<th>Functions of Agent 3</th>
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</thead>
<tbody>
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</tr>
<tr>
<td></td>
<td>• Quality</td>
</tr>
<tr>
<td></td>
<td>• On time delivery</td>
</tr>
<tr>
<td></td>
<td>• Travelling schedule</td>
</tr>
<tr>
<td>2006</td>
<td>• Negotiations</td>
</tr>
<tr>
<td></td>
<td>• Suggesting what suppliers to choose</td>
</tr>
<tr>
<td>2008</td>
<td>• Suggesting new suppliers</td>
</tr>
<tr>
<td></td>
<td>• Terminating relationships</td>
</tr>
<tr>
<td></td>
<td>• Extending all services to new suppliers in China</td>
</tr>
<tr>
<td>2009</td>
<td>• CEO of joint venture</td>
</tr>
<tr>
<td></td>
<td>• Support Chinese employee</td>
</tr>
<tr>
<td></td>
<td>• Service the Taiwanese suppliers</td>
</tr>
</tbody>
</table>

Although BTO 1 was very satisfied with the relationship with Agent 3, there were still two major issues to solve. One was the lack of technical skills. In order to be able to evaluate new suppliers and make thorough quality checks of the products before they left the factory, technical skills were needed. The second problem was the VAT refund for which a registered company was needed in China. Thus BTO 1 decided to set up a joint venture together with Agent 3.

With the new joint venture a whole new set of activities would be added to the network: sales, storage, quality checkups and possibly assembly in China will be added. This would also transfer a new role to Agent 3; that of supervising an employee in China. The new joint venture will also have to deal with the local government in order to be able to claim the VAT. Since technically skilled employees with good English skills are scarce they are extremely costly, but by
letting Agent\textsubscript{1} be part of the joint venture and be the primary contact person for the IPO this interpretational problem is solved.

9.7.3 The trader’s dilemma

Whereas some researchers believe that the role of intermediaries in value creation (Burt, Dobler, & Starling, 2003; Geersbro & Vedel, 2008) and in international business (Ellis, 2005; 2010) is doomed, other researchers are able to see a future where intermediaries continue to have a role in a triadic business relationship provided they add value to the relationship as a whole (Havila, 1996). In the snapshot pictures above of the networks some intermediaries stay and while some disappear (see table 9.3).

Table 9.3 Relationships intended to be terminated

<table>
<thead>
<tr>
<th>Relation Intended</th>
<th>Reasons</th>
<th>Terminated</th>
</tr>
</thead>
</table>
| Agent\textsubscript{4} | • Interpretation  
                  | • Quality  
                  | • On time delivery  
                  | • Travelling schedule | Yes |
| Agent\textsubscript{5} | • Beyond searching for suppliers no real value addition | Yes |
| Agent\textsubscript{2} | • Lack of transparency  
                  | • Late delivery times | No |
| Agent\textsubscript{3} | • Lack of transparency | No |
| STD\textsubscript{6} | • Developed own channels | Yes |

Agent\textsubscript{4} was the first to disappear. According to BTO\textsubscript{1}, the main reason for this was the low amount of orders that passed through him. In order to gain some profit he needed a constant flow of orders. Buying BTO products means that most of the orders on which you spend time, money and effort to assemble an offer, will not reach the stage of an order. This way of working did not suit Agent\textsubscript{4} at all and thus he preferred to terminate the business relationship.

Agents on the other hand was less dissatisfied. She was only part of this network for a year. Although her services were appreciated, BTO\textsubscript{1} found that she soon made herself redundant. Her role was really fulfilled by the help of Agent\textsubscript{3} who had the additional advantage of being in the right time zone. Thus in the end, BTO\textsubscript{1} had to let Agent\textsubscript{3} go.
The business relationship between the two Swedish companies – BTO₁ and STD₂ is also interesting. As mentioned in chapter 9.6.1, STD₂ had no supplier that could produce products using the specific production technique needed for the component demanded, and since the customer was an important one, they had two choices; either to start looking for a supplier in China or elsewhere or use somebody who they knew had the contacts. Since the product was a product that would not have a very long lifetime, they chose the latter. Finding, evaluating and negotiating with a new manufacturer in China are often consuming and costly. In one interview I also found the opposite. During my interview with the former Purchasing Manager of STD₂, who was now a Purchasing Manager at a new company, he explained that the strategy of the new employer was to source all designed parts through direct sourcing channels but for the fasteners and standard products they always used a Swedish intermediary. Thus they managed to lower the number of relationships and number of suppliers while still keeping control over the components that was considered to be the core of the end product.

9.7.4 An Evolving Understanding of Intermediary roles – Tom’s Tale

Within these network snapshots, Tom has received special attention. During the first interview he revealed that he had been hesitant towards China as a sourcing market in his prior position as Purchasing Manager at STDB. In 2006, as CEO of a company that source only from China he had already begun to change this attitude and although still hesitant regarding some uncertainties (quality, on time delivery etc.) he now felt that China was the future even for BTO companies such as his new employer. Although he realized that, from Sweden, you were not able to distinguish agents from representatives, it really did not matter so much since they were needed, if not for language skills then for the translation of business specific discrepancies. The suppliers seemed to have limited understanding of the situation in which BTO₁ was, in between the demands of their customer and the supplier, changes in the specifications would be frequent so that the supplier ended up giving many offers on the same suggestion. Each new offer started up a whole new process of negotiations so that those features that Tom thought they had already reached an agreement on had to be renegotiated. Tom also felt that being a small actor left little possibility to really interact with the suppliers in order to improve quality.

Two years later, when in China, he was convinced that China was the future. Living in China had opened his eyes to the distances that before seemed to be manageable and to the time consuming bureaucracy. Language was still a barrier but Tom now felt that agents are not the solution. On the contrary, agents are not able to improve the relationship between the buyer and supplier.
but only to transfer information, not knowledge. Thus from his new position in China he was able to distinguish representatives (that were still needed since they were usually the only English speaking employee at the factory) and the agents. He also found that he was able to distinguish between reasonable prices and offers that were too low (indicating that there might be some misunderstanding in terms of the specifications or that the supplier was not a serious supplier). The constant battle with bureaucracy had also led him to understand that one of the major advantages that the professional agents had was their ability to sidetrack. This experience must be obtained by suppliers or buyers in order to be able to circumvent the agents wholly.

Finally in 2009, the situation on the market had shifted dramatically but Tom had kept his faith in China as a sourcing market. Living in China had put him in a very advantageous position where he was able to get involved in the restructuring process of the supply chain of the suppliers, granting him to see further into the network beyond the suppliers. Had he been in Sweden it is likely that the products of the suppliers would have ended up in Sweden with the same packaging and he might never have been informed that the products had been produced in another country. The direct interaction with the suppliers had also enabled Tom to get to the bottom of the constant renegotiations although this situation has also greatly improved with the increased experience in Western markets among the suppliers.

### 9.7.5 On evolving roles of intermediaries

From the snapshot figures depicting the supply network of BTO1 at five different points in time four different perspectives on the intermediaries have been drawn. Firstly that intermediated sourcing is not one strategy but many different strategies, secondly, that the role of the intermediary may evolve within a network through time which is evident both in the case of Agent3 and Tom. Thirdly, regarding the termination of relationships with agents it is important that the agent has competences that the buyer need long-term since some services (such as searching for new suppliers) might only be demanded short-term and thus affected by the trader’s dilemma. It is interesting however that the three agents who really guarded their knowledge by avoiding transparency were also replaced because of this.

Finally, the tale by Tom seems to suggest that our understanding of what we really need in terms of an intermediary in China, when still in Sweden, might not be as good as we would like to think. Even the companies with vast experience of sourcing from China have a limited understanding of the market based on the temporary previews during carefully orchestrated visits in China.
Table 9.4 An evolving understanding of intermediary roles – Tom

<table>
<thead>
<tr>
<th>Year</th>
<th>Attitude to China as a sourcing market</th>
<th>Attitude towards agents</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>• Hesitant&lt;br&gt;• Quality problems&lt;br&gt;• Late deliveries&lt;br&gt;• No pre warning when products late&lt;br&gt;• Trips to China not enough to solve problems long-term only to financially settle past problems&lt;br&gt;• Uncertainty in regards to who is an agent and who represents the suppliers</td>
<td>• Agents are necessary for communication and translation both ways&lt;br&gt;• To translate how the products are used in Sweden&lt;br&gt;• To communicate how the inquiry process of BTO products work&lt;br&gt;• To communicate to the Chinese suppliers how to improve quality</td>
</tr>
<tr>
<td>2008</td>
<td>• China is the future&lt;br&gt;• Tough market – everything takes time, from setting up an account to buying a ticket.&lt;br&gt;• The distance makes it harder to make social calls the way he used to do in Sweden&lt;br&gt;• Language is still a barrier</td>
<td>• Agents are to be avoided – IPO is needed&lt;br&gt;• The IPO is able to distinguish between loose agents and those who really represent the supplier&lt;br&gt;• Surprise visits possible&lt;br&gt;• Able to assess what a reasonable price is&lt;br&gt;• Start searching for side tracks</td>
</tr>
<tr>
<td>2009</td>
<td>• Despite heavy set back regarding the EU investigation, the drop in the European market, the raising wages and the likelihood that the subsidies that have held raw material prices low in China, Tom still believes in the Chinese market not only as a sourcing base but also as an intermediary to other sourcing destinations</td>
<td>• The position in China has allowed him to be part of the evolution of the network by his suppliers. He is now informed and involved as they start up production in other neighbouring low cost countries.&lt;br&gt;• The functions of the Chinese IPO is extended to the neighbouring Asian countries&lt;br&gt;• The understanding of the European market among the suppliers has become increasingly apparent.&lt;br&gt;• The cooperation allowing the supplier to give suggestions for improvements or cost savings have improved&lt;br&gt;• Part of the process</td>
</tr>
</tbody>
</table>
On the role of the intermediary - Tentative model revisited

The purpose of this thesis is to explore the role of intermediaries for Swedish SMEs sourcing from China. In line with this the aim of this chapter is to look back at the research questions presented in chapter 1.3.2. This chapter starts with addressing the first research question, i.e. why Swedish SMEs source from China. The extended model of antecedents elaborated on in chapter 5 is here further elaborated upon in relation to what has been found in subsequent themes, and discussed in relation to the findings of previous research presented in chapter 4.1. The next section addresses the second research question that concerned how Swedish SMEs start up their sourcing ventures from China. This is primarily addressed in the second theme (chapter 6) and is here discussed in relation to previous research on internationalization presented in chapter 4.1.

The subsequent sections of this chapter are devoted to the functions and roles of the intermediaries. The tentative model presented in chapter 4 (see figure 4.10), summarizes previous research on intermediaries in the form of eight suggestions on the role and functions of the intermediary. The role and functions of the intermediaries are addressed in all themes but above all in the final three themes (chapters 7-9). The chapter ends with an extended model for functions and roles of intermediaries for Swedish SMEs sourcing from China.

Figure 10.1 Overview of relations between research questions, themes and analysis.
10.1 On Motives, Triggers and Rationalizations

The first research question presented in chapter 1.3.2 is why do Swedish SMEs source from China. Research in international sourcing and low cost country sourcing (LCC sourcing) in particular, all point towards the direction of lower costs as a main motive for sourcing from China (see figure 10.2) though other motives are also mentioned. Motives are addressed in the first theme where the Swedish SMEs describe why they have decided to source from China (see chapter 5), which display that, although the motives are as varied as the cases, low costs take a prominent position in the discussions.

Figure 10.2 Motives for international sourcing (research revisited)

10.1.1 Low costs – trigger or rationalization

Looking at the results presented in the articles, cutting costs as reason for outsourcing, offshoring and/or upstream internationalization is well documented and mainly attributed to a highly competitive environment. Whether looking at China in specific (Nassimbeni and Sartor, 2006b), low cost country sourcing (Lockström, 2007) offshoring (Beaumont and Sohal, 2004; Bellman and Källström, 2005; Cánez et al., 2000; Dabhilkar et al., 2009; Eriksson et al., 2008; Gillett, 1994; Kinkel and Maloca, 2009; Marshall et al., 2004; Power et al., 2004; Wallen and Fölster, 2005) or international sourcing in general (Carter et al., 1998; Christopher et al., 2006; Kakabadse and Kakabadse, 2002; Min and Galle, 1991; Scully and Fawcett, 1994; Swamidass and Kotabe,
10 On the role of the intermediary - Tentative model revisited

1993) cutting costs seems to be the top reason for taking the step. Especially in quantitative studies, which is the method used in many of the articles presented in table 4.2, cutting costs abroad ends up as top reason (c.f. Kakabadse and Kakabadse, 2002; Kinkel and Maloca, 2009).

One of the reasons that low costs seem to have such a unanimous response in the studies might be the way that the questions are formed. The respondent of these studies are usually able to choose more than one alternative which gives no indication of what reason is the most prominent one. Take for example the situation above where the customer more or less forced the supplier to move to China (see chapter 5.2.2). Although the discussion about the low prices of production in China had not gone unnoticed by the company representatives, this in itself was not reason enough even to consider starting up production in China, but the pressure from the customer was. STD9 and OM9 were also aware of the low prices long before the decision came about but for them this awareness was not enough either. The quantitative nature of the surveys that create the foundation of most of the studies on antecedents for sourcing from China fails to explain whether these cost cuttings really are the main reasons why the companies choose to source from China or just the most common rationalization behind an implemented decision. Although it is important to generate generalisable data, it might be questioned how well qualitative data is really able to capture complex issues and generate data that look beyond the rationalisations. If the discussion is on how to prevent jobs from being outsourced to China is based on the qualitative measure that it is mainly a matter of costs it will be hard to reach an understanding between politicians and companies. Although the former purchasing manager of STDB seems to suggest that there was a certain pressure from competitors, rumours that other companies had started to source from China and lowered their prices, they still decided to take it slowly (chapter 5.4.3).

It might be questioned if the total costs of sourcing from China, considering the limited volumes that these companies buy, really are lower. One of the respondents rather bitterly remarks that the customers had time and money to send delegations from Stockholm to find suppliers in China, but not enough to visit his factory in Småland that they have made business with for years. The remark points to a certain interest among some managers in sourcing from China that is one of the triggers that push the SMEs to start sourcing from China. Others claim that, despite the increasing costs of labour, the prices from Chinese suppliers are very low (c.f. chapters 5.4.2 and 5.4.4) suggesting that the raw material in some industries is actually purchased at lower prices in China, making it hard to find a good level of healthy competition between goods purchased in China and goods produced in-house in Sweden (see chapter 5.4.2). This however dawned on the company after they had already started to source from China. Thus, despite the suggestions by researchers such as Lockström (2007) and Kinkel and Maloca (2009) they manage to source low volumes of high quality products at reasonably low prices. The SMEs in these studies are
well aware of that larger companies will have lower prices on their goods but feel that the prices have to be viewed in relation to batch size and complexity of the product.

Thus although lowering costs is of high priority in sourcing it did not seem to be enough for most of the companies in this study (see figure 10.3).

### 10.1.2 Triggers – what really sparks a change

One of the reasons expressed by previous research is global pressure (see figure 10.2). The need for an external trigger or management interest as is expressed by some of the companies (see table 5.1) and has been noted by other researchers such as Scully and Fawcett (1994) who find that smaller companies are less internationally oriented and less experienced, and that they, as a consequence tend to act more reactively than proactively towards international sourcing. The same tendency is noted by Agndal (2004) who elevates managerial attitude towards international sourcing as an important component for change in upstream activities of small firms. This managerial attitude is very evident in some cases (such as BTO3, BTO5 and DSGN1). Indeed, the easiness to source from China has opened up for a whole range of companies that may now find flexible production for their designer goods, even in small volumes (c.f. DSGN3, DSGN4 and DSGN5). Within these industries there is no other alternative but to source internationally. The choice of China is based on recommendations within the industry and relations prior to the decision.

To focus on core business or core activities is also one of the reasons behind choosing to source internationally (see figure 10.2), especially in relation to outsourcing and offshoring (Cánez et al., 2000; Dabhikar et al., 2009; Kakabadse and Kakabadse, 2002; Kippenberger, 1997; Marshall et al., 2004; Power et al., 2004). It is suggested that there are more variables to take into account when the decision is not only where and by whom, but also what happens to the facilities and the people who are no longer wanted in the new organization (Embleton and Wright, 1998; Hendry, 1995). Most of the Swedish SMEs in this study seem to be cautious about the relation between sourcing from China and the situation in the Swedish economy. The general tone among the respondents is a wish to explain and to justify their decision, which may explain the many external triggers that are elevated. There are also other ways in which the consciousness of the respondents shows. When explaining that most of the customers were not from the region the founder of BTO1 adds that he did not wish to compete directly with the neighbouring manufacturers in the region. If possible he would sometimes ask manufacturers in the region if they could match the price. Out of the three cases where the companies had outsourced their production (i.e. OM3, OM5 and DSGN5) only one company managed to keep production in Sweden and tried desperately to hold on to the production in Sweden alongside the purchases from China. If anything, the case of OM5 shows how painful the make-or-buy decision might be. Thus, again,
the outsourcing decisions made by the companies in this study seem to be more attributed to a critical situation caused by external events than as a strategic decision to focus on core activities.

An external trigger, especially related to China, is the pressure that the Chinese government from time to time exerts on larger companies to source the components for their factories locally in China as part of a strategy to transfer know-how into China. This is called imposed sourcing (c.f. Eriksson, 1995; Eriksson et al., 2008; Nassimbeni and Sartor, 2006b). Though none of the cases were directly affected by this policy it might, in the case of BTO2, be the reason why the customer decided to put pressure on the company to start production in China.

### 10.1.3 Towards an extended understanding of motives for sourcing from China

When listening to the respondents explaining why the companies choose to source from China, a clear difference between triggers (why the decision was taken in the first place) and the rationalizations (the reason why the decision to source from China was a good decision) seems to stand out (see figure 10.3). When discussing why the decision to source from was taken, the companies seem to focus on external events, external pressure, and industry structure (in the cases of the design companies). Management interest was not always mentioned as a trigger, but something that was very evident in some of the cases. Indeed the former sourcing manager of STDb admits that the CEO was more eager to start sourcing from China than he was; with the effect that the decision was prolonged for three years.

![Figure 10.3 An extended model of motives of triggers and rationalisations for sourcing from China](image)

When the interviews took place the decision to source from China was of course already made and the companies had already begun to source from
China. Alongside the eagerness to justify the decision was an eagerness to justify the continued action of sourcing from China. The argument for this was the low price, the flexibility, the skills and the resources available in the Chinese factories (see figure 10.3). Despite problems with quality and on time delivery the companies seemed pleased with the decision to source from China. Indeed BTO₁ chose China because it they thought it was easy compared to India and the former Eastern European countries.

What is the effect of this? If low labour cost is not a trigger to the decision to outsource then there is no use in presenting higher degree of automatization as an alternative to outsourcing. Nor will the embargos and the raised import taxes solve the key issues that triggered the Swedish SMEs in this study to change their sourcing destination to China. Apart from where whole industries have turned to China, the triggers were specific to the cases and thus hard to generalize.

The main conclusion regarding research question 1 is thus that although the main reason for the Swedish SMEs in this study to source from China was claimed to be lower costs, this in itself was not enough to trigger a change in the sourcing strategy of these companies. With the exception of the companies that felt inclined by the structure of the industry to source from China, the other companies needed an external event or management interest had to set the process in motion.

10.2 On how to source from China

The second research question presented in 1.3.2 is how do Swedish SMEs source from China? Apart from antecedents, chapter 2.1 also contains a discussion regarding how companies source internationally. The discussion ends in a model that shows the relationship between motives and modes from the perspective of previous research and which outlines five different theories on modes for international sourcing (see figure 10.3). This is the focus of the cases presented in the second theme (chapter 6) and is further discussed below.
10.2.1 Entry modes and entry nodes

At first glance the cases in chapter 6 seem to indicate that intermediaries are no longer needed as suggested by researchers on international new ventures and born globals (Andersson and Wictor, 2003; Knight and Cavusgil, 1996; Madsen and Servais, 1997; McDougall et al., 1994, 2003). Some of the companies in this study brought their contacts from previous job positions (such as in the case of BTO3) or took the advice of colleagues and contacts within the industry (c.f. DSGN4, OM C) or found their suppliers themselves through internet or trade fairs (such as BTO 1 and OM C). Although some of the companies were sceptical, especially towards the trade fairs (DSGN 3) some have found them helpful. There are some exceptions such as DSGN2 where the intermediary was part of the strategy from the beginning and where the special competence of the intermediary makes it unlikely that there will ever be a need to go directly to the suppliers. BTO1, who begun their venture earlier than the other companies in this study, at a time when the technological advances pronounced by the international new venture and born global researchers as prerequisites for their theory were yet not available in China, also used intermediaries as an initial strategy. The cases in chapter 9 reveal that although they now are very aware that times have changed, they still find it hard to go beyond this strategy. The assortment that BTO1 offers their customers in combination with the small volumes require a portfolio of different types of small manufacturers, some of which do not speak English well enough to communicate efficiently. Thus BTO1 finds it hard to go beyond the intermediaries. This relates to the issue of using intermediaries as an entry node, as suggested by Jansson (2007), which
seems to be attached to some difficulties. When the companies try to surpass the intermediary they run into problems, mainly because the suppliers that are contracted by Chinese agents or traders usually do not have English-speaking personnel or export licenses. Thus the Swedish SME is unable to build on the relationships that they form with either the intermediary or the suppliers they meet through the intermediary. The exception is STD\textsubscript{0}, but the only reason as to why they were able to go beyond the intermediaries is that they started the IPO of their own, and with the use of Chinese employees they were able to reach beyond the intermediaries and talk directly to the suppliers. This in turn sparked another revelation that confirmed what had only been a suspicion, that some of the individuals which they had presumed were representatives from the companies in reality were agents. Thus it might be that even if the Swedish SMEs think that they are sourcing directly from a manufacturer they are in reality sourcing through an intermediary.

All in all, looking back at the model in figure 10.4, it seems that among these companies the use of intermediaries as a temporary mode in the initial stage of sourcing as suggested by Rugman (in Nassimbeni and Sartor, 2006b) or as an entry node as suggested by the IBS model (Jansson, 2007) does not seem to be a preferred strategy. At the same time, despite all the assurance suggested by the born global researchers, there seems to be a need for some sort of representation in China, which is why intermediaries were introduced in a later stage, after the initial contacts with the suppliers were already established.

10.2.2 Motives for intermediaries

Although intermediaries seem to be avoided in the early phase of internationalisation the companies seem to experience a need for presence in China when the relationship with the suppliers has started to settle. The main reasons seem to be issues about quality and late delivery of goods. Although faulty products may be returned and either replaced or compensated for in the next negotiation; there are usually no warnings that alert the Swedish SME so that they, in turn, may alert their customers and when the product is on its way back to China the damage is already done. Thus representation in China is perceived as a way to overcome the barriers of quality and on time delivery (see figure 10.4) although not necessarily through control. One of the respondents uses the word “to exert pressure,” i.e. to make the supplier aware that you are close and can respond quickly.

Nassimbeni and Sartor (2006b) suggest that intermediated sourcing is especially appropriate for SMEs, and in their typology two types of intermediated sourcing are suggested, namely that of traditional intermediaries and that of service intermediaries. The empirical material in chapter 6 shows example of each of these strategies with some variety – BTO\textsubscript{1} and DSGN\textsubscript{2} use the traditional intermediaries and DSGN\textsubscript{3} uses service intermediaries from time to time. The companies in this study outline a number of alternative ways to
handle the dilemma. DSGN4, for example, uses the intermediaries and representatives of the sub-suppliers in Sweden to secure the quality of the fabrics and trims, while the intermediary contracted by DSGN1 does not really fit into the category of neither traditional intermediary nor a service intermediary. The intermediary of DSGN1 is integrated into a transparent supply chain not working on the basis of tasks but on the basis of an overall function – to secure quality.

As opposed to what is suggested by Kotabe and Zhao (2002) it does not seem as if the original motives for choosing China as a sourcing market have a direct effect on the selection of mode. Instead it seems that the barriers that the companies experienced affected the choice of mode and then when making the choice between different types of intermediaries (traditional or service intermediary, internal (subsidiary) or external) other reasons are added. None of the companies in the study state the access to China as a market as a motive for starting to source from China or as a motive for the choice of mode. Instead access to China as a market seems to be a solution to the cost of setting up the subsidiary rather than a motive for doing so.

### 10.2.3 The real odd case?

STD is a little different from the rest of the companies in this study although all in all a textbook example in every way. The start up period shows a clear resemblance to the process models both in terms of increased commitment and increased knowledge (Johanson and Vahlne, 1990, 2009; Johanson and Wiedersheim-Paul, 1975). When established in China with an IPO they explore the network of their earlier contacts, first the contacts with Agent2, and then they use the suppliers as intermediaries to access other East Asian markets.

The reason might be their product, a standardised product that is subjected to far more direct competition than the products of the other companies in this study (as suggested by a former purchasing manager of STD). It might also of course be the hesitant nature of the purchasing manager at the time of initiation of the project.

The most interesting point however is that it was not until they deviated from the predestined path of being an SME and established an IPO that STD were able to access the network that was offered by the intermediaries and suppliers. It was not until they had a representative on the Chinese market that had access to the internal network of STD and the real strategy to reduce the number of intermediaries that horizons were extended. Thus through the establishment of the subsidiary they were not only able to improve their activities in China but also improve their access to other low cost countries in the region. In this sense their strategy may be compared to the last stage of the Kotabe and Zhao typology (see figure 10.5) that was developed for large multinational companies in China (Kotabe and Zhao, 2002).
10.2.4 Towards an extended understanding of intermediated strategy

Intermediaries as entry nodes or entry modes are thus not recommended by the companies in this study. Instead intermediaries are a solution to cope with certain barriers experienced and that the respondents associated with sourcing from China, i.e. above all quality control and on time delivery (see figure 10.3). Thus the decision on how to source from China seems to come down to the question on how to overcome these barriers in the best way. In this study, the companies suggest five different solutions with the help of intermediaries (see figure 10.5). First of all there is the solution to source directly but to use the representatives of the sub suppliers to test and secure the quality of the input. This is the strategy used by DSGN4 (see chapter 7.5). With the help of the representatives of the material and trim suppliers in Sweden and through keeping as much technical competence as possible within the Swedish head office (i.e. for example how to make patterns), DSGN4 is able to keep control over most part of the quality without constant travelling and without representation in China.

The second type of intermediated strategy is also a form of a direct strategy and corresponds to one of the intermediated strategies suggested by Nassimbeni and Sartor (2006b), in figure 10.5 called service intermediated sourcing. This is when the companies source directly though outsourcing services to external intermediaries such as in the case of DSGN1 (see chapter 7.2). The intermediaries in China and the Swedish SMEs seem to propose that the use of QC centres in China is a very common way to solve the issue of representation in China, especially when there is a wish to keep a direct contact with the suppliers. Indeed, when Agent1 was introduced it was the supplier who proposed that she should represent the Swedish buyer in Taiwan.
The third type of intermediating strategy suggested in figure 10.5 also corresponds to the intermediating strategies suggested by Nassimbeni and Sartor (2006b). This is when traditional intermediaries are used which usually indicates no contact or very little contact between buyer and seller such as for example in the case of DSGN2 (see chapter 7.3).

In the effort to overcome the quality and on time delivery issues, the companies choose between the use of external intermediaries (represented by the three types of strategies above) and the use of internal intermediaries (i.e. as subsidiary). This becomes apparent both in the discussions in chapter 9 and in the discussion held by the CEO in DSGN3 who are in the process of changing their supply chains. Thus, two strategies for internal intermediated sourcing (excluding manufacturing) are added to the list in figure 10.5. The first strategy is the establishment of a RepO (see appendix), a strategy that involves a comparatively low investment but also limits the activities that may be transferred from the Swedish company to China. The company may visit suppliers, do quality controls both in-house and in the factories and exert pressure by sheer presence, but may not renegotiate a contract. All in all the room to act is no more than that of the external service intermediary.

The fifth strategy is to start a FICE or a WFOE (see appendix), which involves a rather substantial investment. The subsidiary is then granted additional space to interact in China. One of the reasons for choosing this strategy that is suggested by one of the respondents is to protect intellectual property, through sourcing the components outside the company and then assembly the parts in-house. The large investment seems however to drive the respondents to find additional ways in which to cover the costs of the subsidiary, either through sales in China (such as for example BTO2) or through collection of the VAT refund (such as for example BTO1).

Looking at the cases presented in this thesis it is apparent that the differences within each of these strategies are marked. Although both BTO1 and DSGN2 use traditional intermediaries, the ways that they are used are very different. While DSGN2 has managed to develop a very close cooperation with their intermediary that involves the co-creation of products, the relationship between BTO1 and their agents is not as integrated. The same may be found if one compare the two service intermediaries presented in chapters 8.3.1 (i.e. QC1) and chapter 8.3.2 (i.e. QC2). This sparks the third research question, which is discussed in the next section.

10.3 Functions and roles of the intermediaries

As mentioned above, even the cases in this study that did not use intermediaries initially, choose the intermediate mode after establishing a
relationship with the intermediary and sometimes after gaining years of experiences (c.f. DSGN3). Although intermediated strategy is the strategy recommended by Nassimbeni and Sartor (2006) as suitable for small companies, the theories of internationalization would consider this change in strategy a regression in accordance with the process models of internationalization (Johanson and Vahlne, 2009; Nassimbeni and Sartor, 2006b). This sparked the interest that was developed in chapter 4 regarding what the role and functions of intermediaries are. Why do the SMEs choose to involve a third party into the relationship with the suppliers? **How did they perceive the role of the intermediary? How do the intermediaries themselves perceive their role?** This thus became the third research question as presented in chapter 1.3.2. Based on five different approaches (i.e. international sourcing, transaction cost, value chain, and supply chain and role theory) the tentative model presented in figure 10.6 was developed. This section discusses the functions and the role of intermediaries for Swedish SMEs sourcing from China.

**Figure 10.6 Tentative model on the functions and the role of intermediaries revisited**

**10.3.1 The functions of intermediaries – international sourcing**

In the tentative model there are seven suggestions regarding what function an intermediary might have (see figure 10.6). Although intermediaries, as has already been stated in the previous section, were not needed in the initial stage of the Chinese venture (which was suggestion 4), research within international sourcing has some interesting points to our understanding of how
intermediaries are perceived by the Swedish buyer. Though intermediaries are not used as stepping stone in a process as suggested by Rugman (in Nassimbeni and Sartor, 2006b), there is a distinction between the cases where intermediaries are perceived as a long-term solution (such as for example DSGN2, BTO1, BTO2) and the companies where the intermediary is a temporary solution for special orders (as suggested by for example for DSGN3 and QC2). Thus in regards to suggestion 1 and 2, intermediaries are found to be viewed sometimes as a temporary mode and sometimes a long-term solution (see figure 10.6).

In regards to suggestion 3, which suggests that intermediaries might be used as an entry node (Jansson, 2007), temporarily or long-term, it is stated above that the language barrier still acts in favour of intermediaries that wish to avoid the trader’s dilemma. The suppliers that were contracted for the Swedish buyers through the agents were often matched in accordance with size; which meant small manufacturers with limited language skills. Sometimes, as in the case of Agent1, the relationship between the agent and the suppliers also acted as a barrier to surpassing the intermediary. On the other hand, Tom’s tale in chapter 9, shows that when located in China, the subsidiary has the ability to access the network of the suppliers and in this way the agent that was previously used as an intermediary becomes a contact and a “door opener”.

All in all, the international sourcing approach brings forth two interesting points to the subsequent discussion, namely those of temporary vs. long-term perspective in regards to the intermediary and the use of intermediaries as entry nodes. Above all however the cases showed a wide array of different ways in which intermediaries may be used in sourcing from China.

10.3.2 The functions of intermediaries – TCA, VCA and SCA

The model contains three other approaches as to what functions might be attached to intermediaries. From the perspective of the transaction cost approach which suggests that intermediaries are needed to keep down the *ex ante* costs (such as search and negotiation costs) and *ex post* costs (such as monitoring and enforcement) (Peng and York, 2001), again it seems as far as the *ex ante* costs are concerned that the intermediaries are no longer needed by the companies in this study. Indeed the one agent (i.e. Agents) that was employed for searching and evaluating suppliers was the one that really got caught in the traders dilemma (Ellis, 2005). The main service that was provided was searching for new intermediaries and since the assignment was to find suppliers with whom the buyer could communicate – after the initial visits there were no need for her services any more. Indeed, the CEO of BTO1 expresses that Agent3 was so efficient that they did not have the capacity to take care of all the suppliers that she managed to find for them.

The *ex post* costs are however what seem to be troubling the companies. Quality control and on time deliveries was as discussed in chapter 10.2.2 what
motivated the companies to add an intermediary when the relationship had already been established between supplier and buyer.

As far as the upstream functions, suggested by value chain researchers (suggestions 6 in figure 10.6) assortment, accessibility and facilitation of search and comparisons (Coughlan et al., 2001), these functions were not used by any of the companies in the study, at least not in China, although the BTO companies served their Swedish customers with these services. OMB were discussing the possibility of bundling in the facilities that they had set up in China, but at the time of the interview this had still not been fully implemented.

Looking at the six activities suggested by Geersbro and Vedel (2008) from the perspective of the supply chain, none of the companies were needed for financial, logistics or knowledge activities. Logistics and bundling were, as mentioned above, discussed only in the case of OMB.

As for the remaining three activities, i.e. knowledge, indirect and administrative, the Swedish SMEs have very different perceptions regarding the use of intermediaries in regards to these matters. In a way it might be argued that DSGN2 and BTO3 use their intermediaries for their knowledge function since they are cooperating in the design/product development phase. In the case of DSGN2 there is not enough skills within the organisation of the Swedish SME to do patterns or make the final drawings and thus these matters are handled together with the intermediary. In the case of BTO3 the question is not lack of knowledge but rather efficiency, through making full use of the time difference, the Chinese supplier makes the blueprint while it is still night in Sweden. The indirect functions (i.e. marketing, scouting and social) and the administrative function as suggested by Geersbro and Vedel (2008) were only introduced in these cases when the intermediary was internal, i.e. a subsidiary.

When investing in a FICE/WFOE the companies start to discuss how to finance the venture. To increase quality and ascertain on time deliveries it seems is not enough to cover the costs of the investment. One way to finance the subsidiary in China is to encourage sales on the Chinese market, thus adding the indirect functions suggested above (see for example BTO2). The other way to finance the subsidiary seems to be to claim the VAT refund (such as for example BTO1) which would mean adding the administrative function. There is however companies that argue against using VAT refunds as a way to pay for the investment. Tom for example argues that the VAT refund is usually incorporated and visible in the price in his industry, thus claiming the VAT refund would only mean higher prices from the supplier and more administration for the subsidiary. If the company starts a RepO these alternatives are not available since the activities that such a company may perform is restricted (see appendix).
10.3.3 Representation as a function

There are a number of functions in figure 10.6 that are not incorporated in models produced by previous research. The main motive for the companies to add an intermediary is, as stated, on time delivery and quality. On time delivery is suggested by the respondents to be possible to solve by sheer presence. As Tom, QC1 and OMb suggest, when the Chinese suppliers know that a real representative of the Swedish buyer might pop in at any time, the pressure is on. The QC centres usually appoint a time with the supplier so that they know when the representative from the QC will arrive. This gives the supplier plenty of time to arrange for the meeting. In order for the supplier to perceive the intermediary as a true representative of the buyer there seems to be a need for relationships that go beyond the network in China. One of the reasons Tom and QC1 felt that they were able to accomplish as much as they did was their ability not only to interact directly with the Chinese worker in the factory but also that they were able to contact the Swedish SME to ask for advice or to get the correct information. Tom already had an access net within the parent company since he had been working as the purchasing manager there for many years and QC1 had the clear directives to act as a representative of the buying side on every level. This aspect was also elevated by DSGN3 when the CEO explained why they were trying to find somebody to work for them in China on a long-term basis.

A function that might be very specific to China is to detect whether the contact person is a sales representative of the supplier or an intermediary that is acting on its own, for which representation/presence in China is needed. It was interesting to note that some of the companies openly confess that they do not know whether they use intermediaries or not. Using a contracted intermediary, especially if establishing a subsidiary might facilitate the assurance that the person you are dealing with is an actual representative of the supplier and that the products are being produced in the facilities that they are supposed to be produced in. On the other hand, if the Swedish buyer does not have a FICE or WFOE the ability to act might be limited even if they should reveal such an intermediary. Since one of the possible reasons for these types of intermediaries is that the supplier lacks an export license this can only be circumvented if the subsidiary is in possession of an export license of their own.

10.3.4 Quality control as a function

Looking at the cases in chapter 7, quality may be perceived as a set of functions as well as a set of activities. The activities of quality control that was expressed in these cases concerned the actual tests that were performed on the textile, on the trims, the preproduction sample etc. Quality as a function on the other hand might be divided into four functions (see figure 10.6).
Figure 10.7 Quality as a function

The figure suggests that the overall quality is dependent on four functions: the quality of the raw material or input (A), the quality of production (B), the quality of design (C) and the quality of the specifications (D). The arrow shows the direction of the flow of goods. Looking back at the cases in the study there is a need for assuring that the quality of the input, whether it be the fabrics and trims (such as in the cases of DSGN$_2$, DSGN$_3$, and DSGN$_4$) or metal sinter (such as in the case of BTO$_1$). The overall quality is of course dependent on the production processes which are something that the buyers are trying to assess, amongst others through pre production samples, plant visits and through taking references. STDB made sure that the suppliers also supplied the car industry where demands on quality are high. The design is of course important for the quality, and in the case of performance wear this becomes evident since clothes that do not fit well do not live up to the performance promised (as was expressed by the CEO of DSGN$_3$). Finally, if the designs are not properly translated into instructions for the Chinese supplier to understand, the likelihood that the final product will not match the design increases. When DSGN$_1$ decided to outsource their production this became the largest obstacle to handle. The activities that are connected to each of these functions are industry specific, so that the quality control of sinter material involves certain processes while the quality control of the fabric involves other activities. The activities might of course also alter in between companies within the same industry as suggested by DSGN$_3$ in chapter 7.4.

There is however one more aspect in relation to the use of intermediaries. The model above is based on a supply chain consisting of sub supplier, supplier and buyer. If an intermediary is added that is partly responsible for the quality controls, and especially if the intermediary is an external QC Centre, the final quality is dependent on the quality of the instructions that the buyer gives the intermediary.

If related to the five sourcing strategies presented in chapter 10.2.4, the responsibility for each of these functions is distributed differently depending on the chosen strategy. In the case of a traditional intermediary, all functions except for the design/product development function (C) are handed over to the intermediary (see BTO$_1$). On the other hand, in the case of direct sourcing with the help of the sub supplier’s intermediaries (see DSGN$_4$) all the functions
are controlled by the buyer. In the case of RepO and sourcing intermediaries their responsibilities are rather similar although their activities might differ. Since design/product development is kept in Sweden (this is strongly emphasized among the companies) the intermediary, whether a RepO or a sourcing intermediary such as a QC, only takes responsibility for assuring that the supplier is fulfilling his responsibilities to handle the production and input quality. Finally, in the case of a FICE/WFOE the ability to act becomes a little stronger, and if the Swedish company choose to sell on the Chinese market this will of course open up for additional responsibilities, such as making specifications and design for the local market (see WFOE1).

10.3.5 The intermediary as a structural role

The final suggestion that is presented in the tentative model (see figure 10.5) concerns intermediaries perceived as a role. As suggested in the tentative model presented in chapter 4.3.1, the structural role of the intermediary is viewed as a set of norms and expectations (Heidegren and Wästerfors, 2008; Hogg and Vaughan, 2005; Turner, 2001) and is affected by the terms of payment, commission, location, and activities that the intermediaries perform (Burt et al., 2003). The role of the intermediaries is addressed in three of the themes – first from the perspective of four Swedish SMEs in chapter 7 in relation to the function of quality control, then from the perspective of the intermediaries in China in chapter 8 and then finally from the perspective of the Swedish SMEs that try to alter the structure of the supply chain in order to achieve transparency over the quality functions above.

From a structural perspective, the roles are related to expectations and norms of which Burt et al. (2003) gives an example (see table 3.4). Looking at the factors used by Burt et al. to distinguish between the different types of sourcing intermediaries none of the types seems to be fully represented among the cases in this study. Since most of the intermediaries were contacted after the establishment of the buyer-supplier relationships, full exclusivity was not really an option. In the case of DSGN3 however the intermediary became part of the design process and thus weak visibility was accepted. All intermediaries that were interviewed were commissioned by the buyer, although all but the subsidiaries are independent companies. There seems to be a large grey zone here though. Looking at the way that companies have been approached by intermediaries that they thought were representatives of the suppliers, where the suppliers find it very well to just play along (c.f. 9.4.2) suggests that it might be that supplier relationships that Swedish SMEs believe to be direct are in fact handled through an intermediary. Although it seems by the comment from Tom that this type of intermediation is familiar to the Chinese suppliers, to the Swedish SMEs this kind of intermediation is met with suspicion. The Swedish SMEs in this study are rather unanimous in their perception of the role of the external intermediary. The word impartial is frequently used to characterise the
external intermediary. Although impartial seems to have good connotations, it is contrasted to representation, which becomes the key word for the alternative strategy of setting up a subsidiary.

At the same time just because the Swedish SME feels that it has found the agent and is the creator of the supply chain does not automatically mean that the intermediary feels that it is commissioned by Swedish buyer. The expectations on this seem to differ among the intermediaries. Agent 2 describes himself as an impartial actor between buyer and seller as do QC 2. In the case of Agent 1 (see chapters 8.2.1 and 9.2.1) however he does not perceive himself as working for the Swedish buyer, but rather as a trader that seizes opportunities to help his mainland friends when they appear. Thus he feels more as a representative of the suppliers to the buyers than as a representative of the buyer to the suppliers. The impartiality is also laden with other connotations that are suggested by, among others, QC 2 and Agent 3, who suggest that getting involved in the day to day quality work in the factory would be to interfere in the affairs of the suppliers. BTO 1 attempts to overcome this difference in view through the means of payments. Despite paying the Taiwanese intermediary (Agent 3) on a fixed commission the lack of technical competence prevents the intermediary to really go beyond the negotiation and monitor activities to get involved in a continuous improvement of quality. To a certain degree language and cultural knowledge seem to be sufficient for making the quality visits, but in order to become involved on a long-term basis it seems that technical skills (see chapter 8.4.1) or access to the technical skills from the Swedish SME/buyer (see chapter 8.3.1) are perceived to be needed to go beyond the specifications. Thus the functions and know-how within the companies that are described in chapter 10.3 become both an opportunity and a limitation as to what role the intermediary may have in relation to the buyer and seller. The payment in itself does not seem to be able to alter the intermediary's role.

What the Swedish SMEs in this study appear to want is, however, full representation, not only activities to be performed. In order to accomplish this, the respondents discuss strategy, terms of payment and the characteristics and background of the person that should occupy the position. In terms of strategy the choice is usually between a service intermediary or a subsidiary, where as described above, the Swedish SMEs perceive the external intermediaries to lack commitment to long-term quality improvement work. When it comes to terms of payment it is a question of fixed commission (a guaranteed monthly salary) or variable commission (i.e. related to the specified activities asked for). Finally, the discussion boils down to a discussion regarding nationality and technical competence of the employee or the representative of the external intermediary. Here the ideas differ, some would prefer a westerner positioned in China whereas others would prefer a Chinese representative. A western contact in China would greatly improve the communication between the buyer and the intermediary whereas a Chinese representative is expected to work better with
the suppliers. All in all there seems to be a difference in expectations and norms between the Swedish SMEs and the Chinese intermediaries. When discussing Chinese representatives, the Swedish SMEs perceive that there is a trade-off between technical knowledge and language skills. Both are very important but an employee with both competences will demand a high salary and is likely to find a better position quickly.

10.3.6 The intermediary as an interactive role

If the negotiations regarding functions, activities and competences are explicit and openly discussed the role of the intermediary in terms of intuitionism is addressed more implicitly. In the tentative model the interactive approach is represented by two different types of triads; the unitary and the serial triads (c.f. Hogg and Vaughan, 2005 and Havila, 1996). Although the differentiation between unitary and serial triads suggests that the relationships between the three actors may not be equal, the triads depicted by Havila (1996) and Hogg and Vaughan (2005) show triads where only one relationship is weaker than that of the other two.

Among the cases in this study there are examples of each of these two types of triads, the unitary triads such as QC1 and the serial triads such as Agent1. Within these types of intermediaries there are differences. In some serial triads, such as Agent2, the contact between supplier and intermediary is more close on all levels within the organisation whereas in other serial triads the contact between buyer and intermediary is weaker, such as in the case of DSGN2 that makes full use of position of the intermediary in the middle and their technological know-how to get involved in the design phase of the apparel line of functional clothing (see chapter 7.3).

The degree of involvement in the relationship between buyer and seller also differs between types of intermediaries. Some show a very high degree of involvement, making sure that the communication between the buyer and seller are continuous on all levels (c.f. chapter 8.3.1) whereas other intermediaries value their independent status and show very little interest in developing the relationship between buyer and seller (c.f. chapter 8.2.2). In part this might be a defence strategy against the traders’ dilemma (Ellis, 2005, 2010) where the agents prevent too much contact between the suppliers and the buyers so that they will not be able to trade directly and surpass the intermediary. What this suggest, whether an intended strategy or not, is that although all relationships within the triad are equally strong there is dimension that is not captured by the way that triads are depicted (c.f. Gadde and Snehota, 2001; Havila, 1996; Hogg and Vaughan, 2005). Although all relationships are equally strong per se, QC1 and Tom have one thing in common; they both invest their time and effort into improving the relationship between buyer and supplier on all levels. This means using the network on both sides to make sure that the right person with the...
right knowledge in the buyer’s organisation is contacted when problems occur for the Chinese supplier. It means getting involved on a long-term basis.

It seems also that there is a third type of intermediary, one where transparency exists but where the buyer-intermediary relationship is as weak as the supplier–intermediary relationship. An example of this would be the quality centres such as QC2 who although commissioned by the buyer, perceives itself as an independent actor only performing certain tasks and not taking stand.

10.4 Towards an extended understanding of functions and roles of intermediaries

Figure 10.7 shows the adapted model based on the discussion presented above. The model suggests that although motives for sourcing to China may be divided into triggers and rationalizations, the motives for using intermediated strategy when sourcing from China is related to two issues – quality and on time delivery. This affects the functions of the intermediaries as well as the role. The activities that the different types of intermediary incorporate in the monitoring function differ however and whereas the service intermediaries work in accordance to specifications there seems to be a desire from the Swedish buyer to change the role of the intermediary to become involved in the establishment of a long-term cooperation for better quality.

The empirical data in the themes display five different types of intermediated sourcing strategies; the direct, the service intermediary, the traditional intermediary and two types of subsidiary intermediaries. Each intermediary shows a different form in relation to the factors described in the bottom part of figure 10.7 in regards to transparency, proximity and involvement.

Related to the sourcing strategies suggested in chapter 10.2.4 (see figure 10.4) two of the strategies seem to result in serial triads of sorts; the direct intermediated sourcing strategy and the traditionally intermediated strategy. In the case of BTO1 that uses for example Agent1 as a traditional intermediary the possibility to look beyond the intermediary is limited. Although there is contact, payments usually go more or less directly, visits are done once a year and sometimes issues regarding the transportation is communicated directly between buyer and supplier, the contact is marginal. In the case of DSGN4 on the serial triad takes an unorthodox figure. DSGN4 stays in control through the contact with the subsidiaries of the sub suppliers. Through accessing the correct specifications from them, DSGN4 is able to make the product specifications even more detailed. These specifications are later used by the supplier when ordering the input. The Service Intermediated strategy shows example of a different type of relationship structure. When the companies use intermediary QC centres the relationships between the actors and the
intermediary seem to be equally weak (c.f chapters 7.4 or chapter 8.3.3) and create more of a wheel type of triad. Beyond what is clearly expressed in the service agreement there appear to be little interest from either side to establish any long-term relationship. Still, as long as the QC centre fulfils the tasks outsourced to them, the buyer will continue to employ the same QC again and again, which eventually leads to a relationship that becomes more of a prolonged temporary relationship without commitment in terms of knowledge or monetary investments. Looking at how QC2 describes her work, assignments are not yet divided between the controllers based on the technical competence of that individual which means that they have little possibility to go beyond the quality control specifications handed to them even if they wanted to.

In the case of a subsidiary the ties to the Swedish subsidiary seem to be stronger, but the case of Tom shows that with the establishment of the subsidiary the relationship with the suppliers might evolve. On the other hand, a subsidiary does not necessarily mean that the contact with the parent company is strong. The case of IPO1 shows how the parent company struggles and sends a representative every other month, in order to strengthen the relationship.

Thus the serial triads that characterize the agents in this dissertation show a difference in proximity and degree of involvement, despite similar terms of payment, which is one of the ways in which the Swedish buyers attempt to alter the role. Instead of using a variable commission related to the specific activities that the intermediary perform (such as in the example of QC2), the option of using a fixed payment related to function instead of activities the Swedish buyer hopes that the intermediary will feel closer to the buyer. Although DSGN1 succeeded in this task (see chapter 6.3.1), BTO1 seems to struggle (see chapter 9).

The key to developing the role of the intermediary in relation to the buyer and seller in order to become integrated is suggested to lie within the know-how of the intermediary in terms of professional, cultural and linguistic capabilities. The importance of language skills is decreasing as more Chinese learn to speak English but the need for cultural translations is still needed from both sides. Here is one of the clear discrepancies between the perceptions of the Swedish buyer and the intermediaries in China. The Swedish buyer looks for someone familiar with the Chinese language and culture and preferably with a good local network. The intermediaries in China emphasize the importance of dual cultural and linguistic competence. It is not only about translating the language but also about translating the needs of the buyer’s customer.

Technical know-how is also a very important factor. When technical production know-how exists among the Swedish buyer it is important to transfer this knowledge to the suppliers in order to help them improve quality long-term. This might be done through travels, through an subsidiary or through an open communication when the technical know-how is sufficient on both sides.
Figure 10.8 Adapted model of intermediary’s role, function and activities
Final reflections on Intermediary roles

The purpose of this thesis is to explore the role of the intermediary in the context of Swedish SMEs sourcing from China. Although the research questions are discussed in the previous chapter, a final note on intermediary roles is called for. This chapter contains final reflections regarding the theoretical and practical contributions of this study as well as a discussion on further studies.

11.1 On intermediary roles

The Swedish SMEs and the intermediaries in China seem to have a clear idea about how the role of the intermediary in China may be perceived. The main reason for involving an intermediary when the business relationship with the Chinese supplier is already established seems to be quality and on time delivery. The problem with on time deliveries seems to be handled through presence, not necessarily in the form of monitoring but in the form of clear representation. It seems that the understanding that the Swedish representative may visit at any time to check if the products actually are in production is enough to increase the likelihood that the goods will arrive on time.

Quality on the other hand demands a cooperative action between all actors involved. In chapter 10, I suggested that the activities concerning quality control may be divided into four functions that may be divided between the actors in different ways, depending on a number of factors concerning all actors in the network. Amongst other things the technical competence in combination with language skills seems to be important. Thus the division of functions between the buyer, supplier and intermediaries are very different among the cases.

The perceptions of what role the intermediary should have differ as well. The role, as opposed to the functions and activities, may be broken down into a number of factors; the ones found to be important in this study are found in the adapted model in chapter 10.

Although both the SMEs in Sweden and the intermediaries in China perceive the role of the external intermediary to be independent and impartial, their understanding of the meaning of these words seems to differ. According to the Swedish SMEs the external intermediaries are independent in the negative sense that they are not properly representing the buyer to the supplier. The intermediaries in China seem to view independence as positive, a neutral
ground for buyers and suppliers to meet and discuss. So while the Swedish buyer is trying to get the intermediary in China more involved, resigning to the possibility of starting a subsidiary, the intermediary in China is trying to hold on to the independence. In this sense it seems that the role of the intermediaries is perceived much as suggested by the structuralist view suggests, as different strategies you may choose between. When the Swedish SME chooses an external intermediary they may choose between an agent and a service intermediary and they think they know what services they are going to get.

There is however intermediaries that have chosen to work long-term with their suppliers. One example of this is the integrated way that DSGN\textsubscript{2} works with their intermediary and involves them already in the design phase. Another example is that of QC\textsubscript{2} who has managed to develop a good network within the buyer’s organisation as well as the supplier’s organisation, enhancing relationships at all levels.

11.2 Implications for future research

The Swedish SMEs in this study separate motives from triggers which is something that other researchers have found in regards to SMEs as well (Agndal, 2006). Although low costs are usually the reason for companies to do any production or sourcing related changes, there is research that suggests that these expectations are usually exaggerated (Carter et al., 2009). The empirical data in this thesis suggest that the same discrepancy might affect research on motives for sourcing from China if not distinguishing between triggers, motives for sourcing from China and motives for choosing to be present in China. Thus it would be interesting to see research that looks into the motives of SME for upstream internationalisation that include a separation between triggers and motives as well as connection to country to source from.

The main focus of this thesis is intermediaries, an area that is still open for research. This thesis focuses on sourcing intermediaries in a very specific context, i.e. sourcing from China. Considering the limited number of studies on sourcing intermediaries there is still much to learn. Despite the gloomy picture suggested by Ellis (2005) the companies in this study that use intermediaries do have a future in international sourcing but what that role is would be interesting to find out yet to discover.

The role of intermediaries is especially interesting. Although using an interactionist approach there is a tendency to create typologies that become very similar to the structuralist view of intermediaries. If roles were negotiated in the relationship between actors then it would be valuable to study these interactions on a long-term basis in order to understand how they develop and how the goals of the individual actors are negotiated to create these roles.

Low cost country sourcing is moving up on the agenda and there are still much that we need to understand about how and why companies source from
low cost countries. In transition economies such as China, conditions are changing fast which demand more from the buyers. Although quality and on time delivery play an important role in the interaction between the companies in this study, considering the increased interest in corporate social responsibility among western companies, research on what role the intermediary might have in the transfer of knowledge regarding corporate social responsibility from buyer to supplier.

11.3 Practical implications

The practical implications are many. The stories of these companies give many suggestions and show proof of the experience of those who are already sourcing in China. Especially chapter 7 that shows four very different supply chains of four rather similar companies should be interesting reading for any purchasing manager who is thinking about sourcing from China. Despite similar products, companies do not design their supply chain in a similar way and thus the question whether or not to have an intermediary is highly contingent on multiple factors such as when and how quality is checked. The relationship with the supplier is also a factor, but even when the relationship is considered very close, flexible and good, an intermediary might enhance the relationship.

The stories also suggest that the travel and buy strategy is not sufficient for sourcing in China. The problems suggested by Tom in the final theme was amongst other things that since the intermediary usually is the one planning the trip you only see what they want you to see. Some respondents were sure that the factory they visited did not have the machinery that could be used for producing their products despite claiming so. Although it might not be perceived as a problem that the person you believed to be a representative of a supplier in reality is an agent, it might be harmful for the possibility of the agent to interact on all levels with the supplier, not to mention the buyer. Thus in the end, mistaking an agent for a representative might become a barrier for the relationship to evolve.

This alone is a contribution for practitioners beyond Swedish SMEs. Apart from this there are other practical implications from this research. First of all, for the managers that are reassessing their sourcing strategy the main question is not whether to have a Chinese manager or a Swedish manager, a Chinese who is proficient in English or a Chinese that is technically skilled, but how they wish the intermediary to interact with the buyer and supplier. Considering the level of exclusivity, how the payment affects the role of the intermediary, how the intermediary will be able to build up its contact net not only in China but also within the Swedish organization is very important. Using QC centres short-term will only fulfil the functions or activities asked for but not the role.
For finding and evaluating suppliers intermediaries are not necessary, according to the respondents in this study. Not even in industries were the possibility to achieve a continuous flow of orders, leading to a continuous search for new suppliers to accommodate the wide range of demands from the customers, do companies feel that intermediaries are needed for this purpose. Although one of the companies has continued to use intermediaries in a period when they were trying to move away from the agents in China, these types of services are most easily made redundant. What is worse; they might create an additional problem. As could be seen by the attempts of BTO1 to go beyond their intermediaries they soon realised that the intermediaries, found suitable by the agents, had the right size and the right quality but not any English speaking personnel or there might be issues with the export license. Thus the use of intermediaries for finding suppliers might prove futile.

Although the Swedish SMEs complain that the Chinese suppliers are late to let them know when deliveries are due to be late, the Chinese QC2 seems to suggest that the Swedish buyers are acting too slowly in regards to the initial stages of the sourcing process. After negotiations are through they find that it takes too long time before the order is finally there. This might be something to consider for the Swedish buyers.

There have been many attempts and discussions where production rationalizations have been regarded as a good alternative to source from China. In the cases where rationalizations are possible and raising the contribution margin is the main reason for the decision to source from China this might prove to be an efficient method. As we have seen in this thesis however, low costs are often not reason enough to start sourcing from China and against the external triggers these types of calculations will not help. The large companies will continue to put pressure on the small suppliers.

The cases in this dissertation also tell us that it is not only important that the representative in China is proficient in the Chinese language and culture, it is equally important that they understand the Swedish business culture. The intermediary, whether internal or external, positioned in the middle needs to be well connected on both sides. When the SMEs discuss starting up a subsidiary or using an intermediary in China, they emphasize the importance of finding a person that is well connected in China, with Chinese language and culture skills and technical know-how so as to be able to interact with the suppliers. This will however only service one side of the triad. It seems to be equally important that the representative in China is well connected in the Swedish organization and familiar with the Swedish market in order to be able to transfer the understanding of the customer demands to the Chinese suppliers. When able to adhere to the needs of both supplier and buyer, the intermediary is able to fulfil their role in the middle.
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Appendix – Foreign-Invested Enterprises in China

This appendix contains information regarding the different types of organizational forms that are available to foreign companies that wish to establish a subsidiary on mainland China. The information is provided by NIP (Nordic Industrial Park), one of the first foreign owned industrial parks in China, based on information material and two interviews, one with Noam David Stern in Ningbo in 2008 and the second interview with Andreas Ehrensjö, sales representative in Sweden, in 2009.

NIP is situated in Ningbo, in Zhejiang region, the region with the highest percentage of privately owned companies and from which region many Swedish SMEs today buy their products. Ningbo is a small town with approximately 6 million inhabitants situated opposite Hangzhou bay from Shanghai, thus within 2.5 hours from Pudong International Airport and has the fourth largest container harbor in China. The region offers a diversified industrial base with production in areas such as electronics, steel, metal processing, plastics and rubber, petrochemicals etc. NIP offers foreign companies, especially companies from the Nordic countries, both services (such as guidance, translation, legal aid, administrative aid, contact with local governance etc) also facilities both in terms of offices and in terms of larger facilities for storage, assembly or production. As opposed to Chinese owned industrial parks, these facilities are fully equipped (including electricity and water). NIP also argue that the mix of Chinese and Nordic service personnel will facilitate for the companies in the park to avoid the high costs of using expatriates as managers for their ventures. NIP has also invested in an innovation centre to create a meeting place for Nordic and Chinese industry.

There are today three types of company structures recommended by NIP, representative office (RepO), Foreign Invested Commercial Enterprise (FICE) and wholly foreign owned enterprise (WFOE). The least capital intensive form of investment is the RepO (see table A1). To start a RepO no capital investment is needed, you may hire employees to do all the services provided by quality controllers, i.e. marketing investigations, search and evaluate suppliers, quality controls, and production follow up. The RepO may negotiate prices but may not close any deals or sign any contracts. The lack of administrative rights prevents the RepO to sell to customers on the Chinese market and to claim VAT refunds (which means that they are not able to access the “Chinese” prices”.

When registering for a FICE the rights are expanded to include the ability to sign contracts and handle payments. In effect the company is able to apply for
an export license and buy at domestic prices, but is then required to handle all
the administrative work for export and transportation. The storage function
and repackaging allows for example a company to produce one set of garment
in one factory and then sort out the sizes and colors in China, do a final quality
test and then send directly to distributors outside Sweden. Registering for a
FICE also opens up for sales on the Chinese market. Still no “value adding”
activities may be performed in-house. Thus you may repackage, do in-house
quality control and store the goods. This may also reduce the cost of unloading
in Sweden since standard transportation agreements usually only allows for one
hour of unloading at destination in Sweden. If unloading takes longer time the
buyer must pay for the extra time that the container is standing still. Without
proper marking on the boxes the time restriction might cause extra costs.

In order to do assembly or alter the products the company must register for
a WFOE. The possibility of in-house assembly provides you with better
protection for your patent since none of the manufacturers that produce the
core components have the full picture while at the same time you may make in-
house quality control of components before goods are assembled.

The choice between the different types of company forms is also affected by
the size of the capital investment that differs and the article of association that
needs to be registered. The article of association is a detailed declaration of the
activities that the new company will undertake in China. In this declaration, the
foreign owner must set the scope of the business activities (number of
employees, annual turnover, amount of export / import, production scale etc.).
Above all you must state the amount of capital invested and capital registered in
China (i.e. capital that is registered on a bank account in China and set aside for
costs related to the operations of the company). In China the relationship
between the total investment and registered capital is controlled through
regulation, so that the higher the total investment the lower the percentage of
registered capital. Still, if the planned investment is below 3 million USD, 70%
of the capital must be registered on a bank account in China, verified by an
accountant at the bank. Although the registered capital is a set fund for the
company to use in any way that they see fit (i.e. employees’ salaries, rent,
invoices from suppliers etc.) the money must be used in China, which means
that it is locked away for the parent company to use in the home country. Thus
small companies with low liquidity need to keep the investment as small as
possible. On the other hand, should they need more money than they have
registered (in case of unforeseen events such as higher salaries than expected
leading to additional costs) the procedure of registration starts all over, with
new registration fees and administrative delays. Thus the registration of a FICE
and WFOE requires that the foreign company either have available funds to
pay for the venture or is able to take a loan in their home country (since loans
at Chinese banks are often too expensive)

(For more information regarding documentation needed and the current
levels of capital see for example www.pathtochina.com.)
Table A1. Company forms in People’s Republic of China (information retrieved from NIP)

<table>
<thead>
<tr>
<th>Functions</th>
<th>RepO</th>
<th>FICE</th>
<th>WFOE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Market investigation</td>
<td>Full ownership</td>
<td>Full ownership</td>
</tr>
<tr>
<td></td>
<td>Search for suppliers</td>
<td>Trading</td>
<td>Import-export</td>
</tr>
<tr>
<td></td>
<td>Quality control</td>
<td>VAT</td>
<td>Marketing and sales</td>
</tr>
<tr>
<td></td>
<td>Production follow up</td>
<td>Swedish board</td>
<td>Invoicing</td>
</tr>
<tr>
<td></td>
<td>Network building</td>
<td>Import and export</td>
<td>VAT</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Limited trade</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Swedish board</td>
</tr>
<tr>
<td>Legal limitation</td>
<td>No contract</td>
<td>Contract</td>
<td>Contract</td>
</tr>
<tr>
<td></td>
<td>No payments</td>
<td>Payments</td>
<td>Payments</td>
</tr>
<tr>
<td>Capital investment</td>
<td>No capital investment</td>
<td>Capital investment</td>
<td>Capital investment</td>
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<td></td>
<td></td>
<td>(TI/RC)</td>
<td>(TI/RC)</td>
</tr>
<tr>
<td>NIP recommendations</td>
<td>&gt;3 million SEK/year</td>
<td>&gt;5 million SEK/year</td>
<td></td>
</tr>
<tr>
<td>Suggested activities by NIP</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Search for more than one supplier</td>
<td>VAT refund 0-13%</td>
<td>Purchase of components from Chinese suppliers</td>
</tr>
<tr>
<td></td>
<td>Supplier new if new products or new supplier</td>
<td>Possible cheaper finance of trading</td>
<td>Own quality control of each component</td>
</tr>
<tr>
<td></td>
<td>Local negotiation</td>
<td>Invoicing</td>
<td>Low cost assembly</td>
</tr>
<tr>
<td></td>
<td>Quality control in production</td>
<td>In house quality control, packaging and storage</td>
<td>Total quality control of product or system</td>
</tr>
<tr>
<td></td>
<td>Quality control when delivery</td>
<td>Sales in China</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Pressure on existing suppliers less travelling</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Efficient travelling</td>
<td></td>
<td></td>
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</tbody>
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