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# Sourcing in China

## Pre-Study Autumn/Winter 2007

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### *Localization Levels of Multinational Companies in China*

*Theme interview study by*  
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# Agenda

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- Introduction
- Motivation
- Research Framework
- Results
- Conclusions

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# Introduction

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- The pre-study was initiated by MASSI Project
  - Primary Research Planning:  
Clarify the degree of mass customization (MC) in the Chinese operations of Multi-national Companies (MNC)

# Motivation

|                    | Finland + Scandinavia                                       |                                                                                      | PRC/ Shanghai                                                  |          |
|--------------------|-------------------------------------------------------------|--------------------------------------------------------------------------------------|----------------------------------------------------------------|----------|
| <b>Strength</b>    | High R&D                                                    |  | Large population/ workforce                                    | <b>S</b> |
|                    | High level of education                                     |                                                                                      | Low labor cost levels (compared to Western standards)          |          |
|                    | Rule of law                                                 |                                                                                      | Mass production capacity                                       |          |
|                    | Customization capability                                    |                                                                                      |                                                                |          |
| <b>Opportunity</b> | Worldwide marketable products                               |  | Cluster effects (similar to SEZs)                              | <b>O</b> |
|                    | Focus on (economic) core-competencies                       |                                                                                      | Rapid know-how advancement                                     |          |
|                    | Environmental consciousness                                 |                                                                                      |                                                                |          |
| <b>Weakness</b>    | Small domestic market                                       |  | Low educational standards                                      | <b>W</b> |
|                    | Little natural resources (fossil fuels, minerals, ore, ...) |                                                                                      | Low awareness of total cost concept                            |          |
|                    | Harsh winters                                               |                                                                                      |                                                                |          |
|                    | Late-comers in PRC                                          |                                                                                      |                                                                |          |
| <b>Threat</b>      | Relying on earlier success                                  |  | Dependent on resource imports                                  | <b>T</b> |
|                    | High tax levels                                             |                                                                                      | Congestion of infrastructure (road, electricity, urban sprawl) |          |
|                    |                                                             |                                                                                      | Increasing wealth inequalities                                 |          |
|                    |                                                             |                                                                                      | High pollution levels                                          |          |

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# Motivation

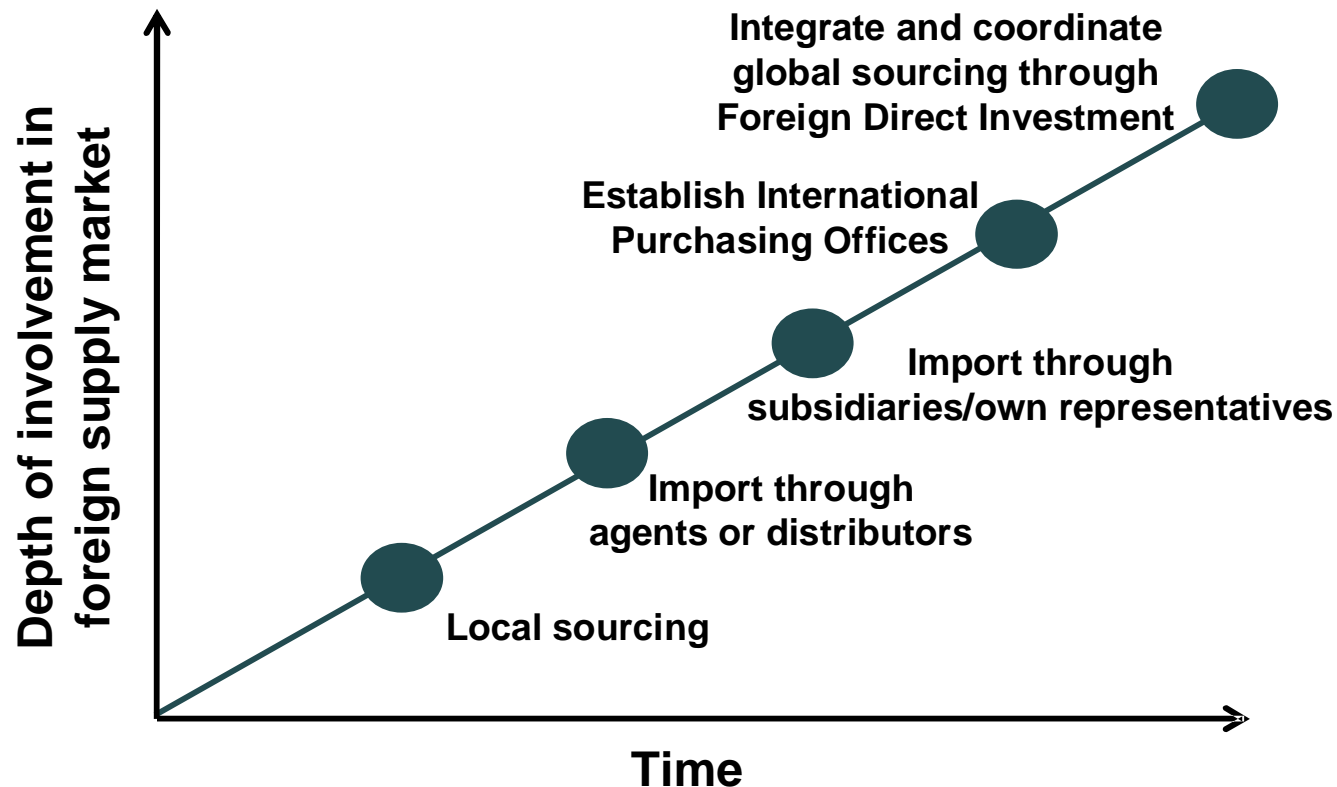
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- Early result:  
Chinese operations are mainly focused on mass production – not on MC like in Finland
- However:
  - Most companies came only after 2001 to China. Yet, the interviewed companies are at different levels of operational localization.
  - Some of the interviewed companies are at very advanced levels of localization

# Motivation

## Example: Global Sourcing

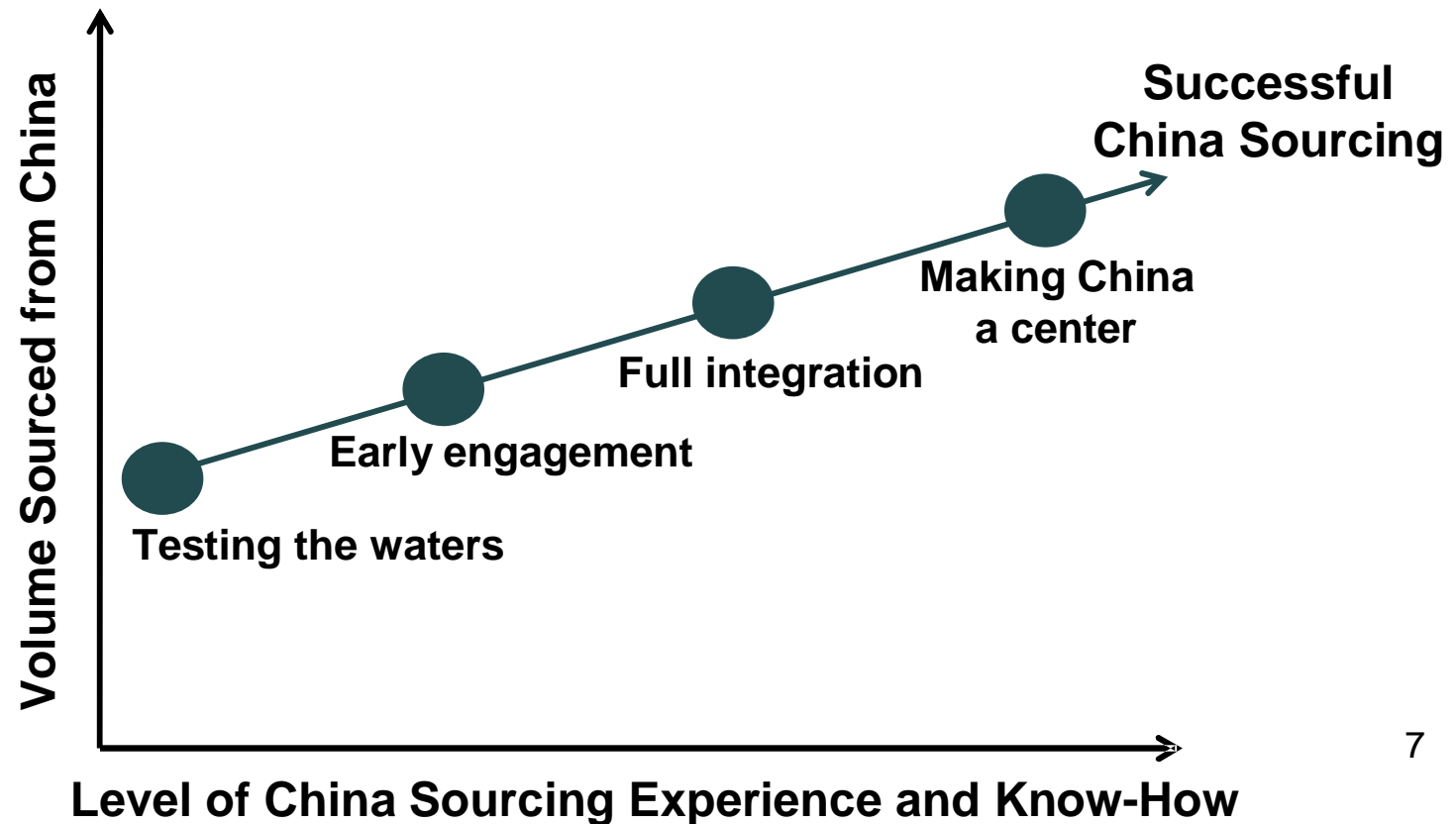
- Framework 1:  
Modes of international sourcing entry strategies  
(Chadwick, Rajagopal, 1995), chapter 10



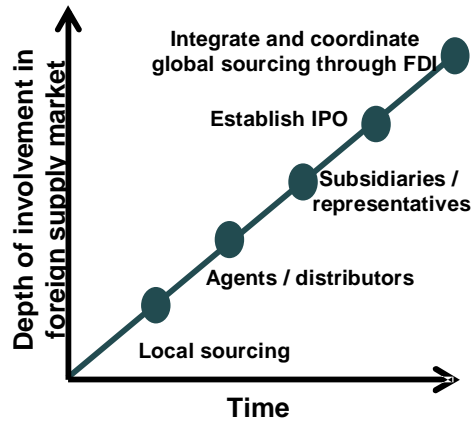
# Motivation

## Example: Sourcing from China

- Framework 2:  
Stages of Integration (Hemerling, Lee, 2007)

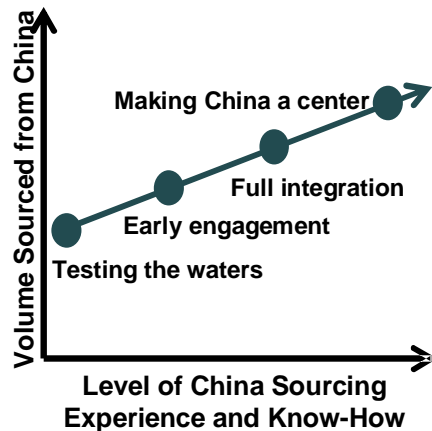


# Research Gap



Focus on:

- Sourcing and
- Manufacturing



Focus on:

- Sourcing and
- R&D

Assumption:  
To maximize the leverage and the synergies  
localize business functions as much as possible.

## Research Framework 1/3

- Research Question:
  - What is the degree of localization of MNCs operating in China today?
  - Have the companies achieved their initial goals?
  - What are their future goals?

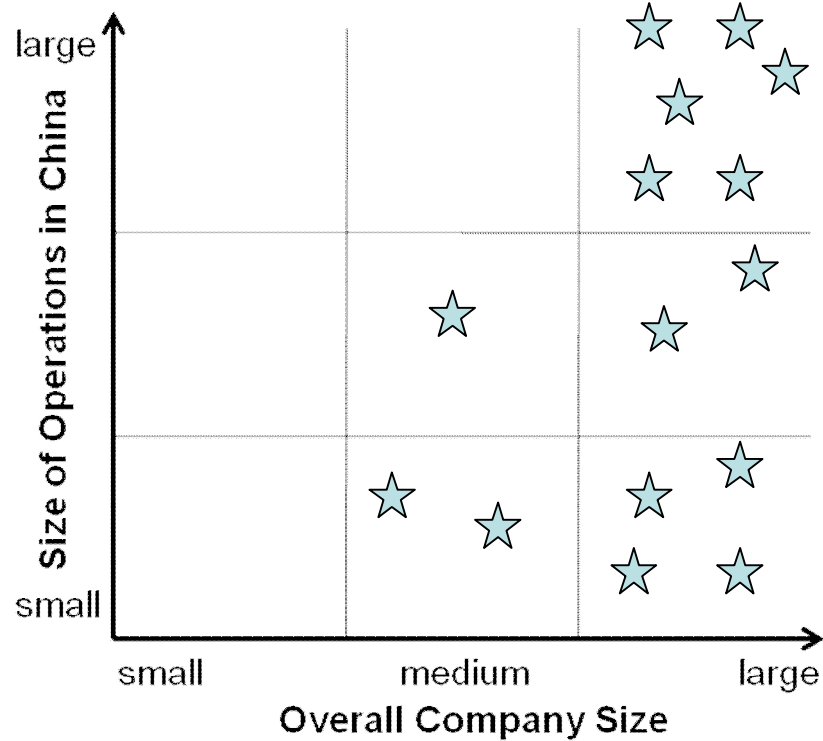
## Research Framework 2/3

### Interview Study

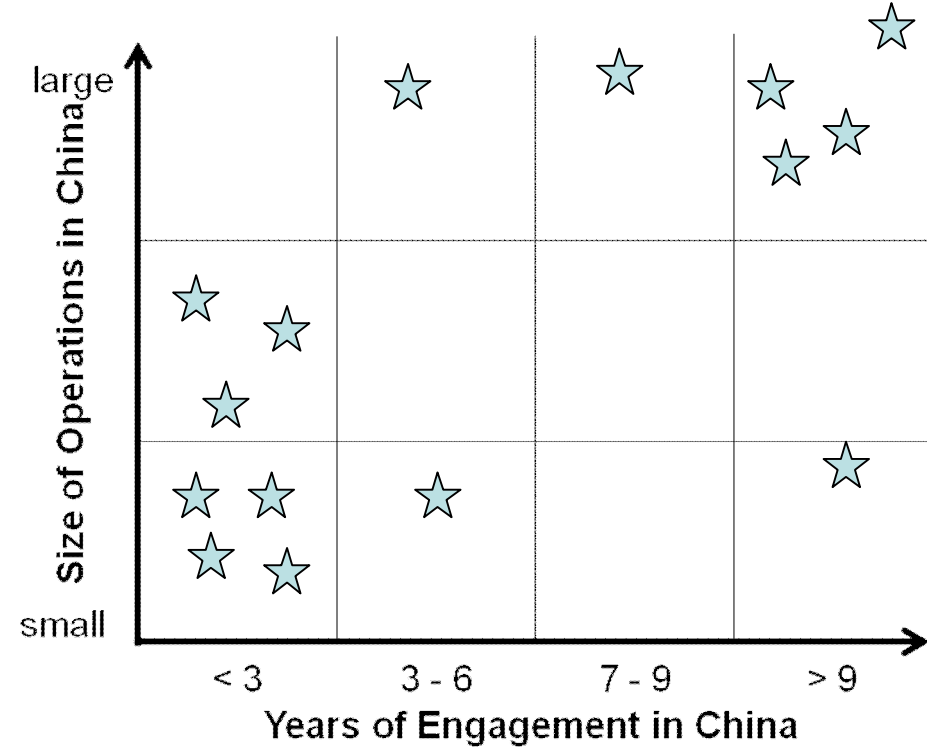
- Interviewees:
  - 20 high-level executives of 15 MNCs
  - HQs in Finland 10, Scandinavian 3, other European 1, Asian 1
- Duration:
  - ca. 2 hours each
- Industry sectors:
  - Mechanical Engineering
  - Electro-Mechanical Engineering
  - Engineering Services

# Research Framework 3/3

## Company overview



## Years of Engagement in China



|        |          |           |
|--------|----------|-----------|
| Small  | < 50     | employees |
| Medium | 50 – 249 | employees |
| Large  | > 250    | employees |

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## Sale markets of MNCs Chinese operations

### Nowadays

worldwide = 3

China = 3

Asia = 6

home markets = 1

none i.e. starting = 2

### In Future Plans

worldwide = 5 (+2)

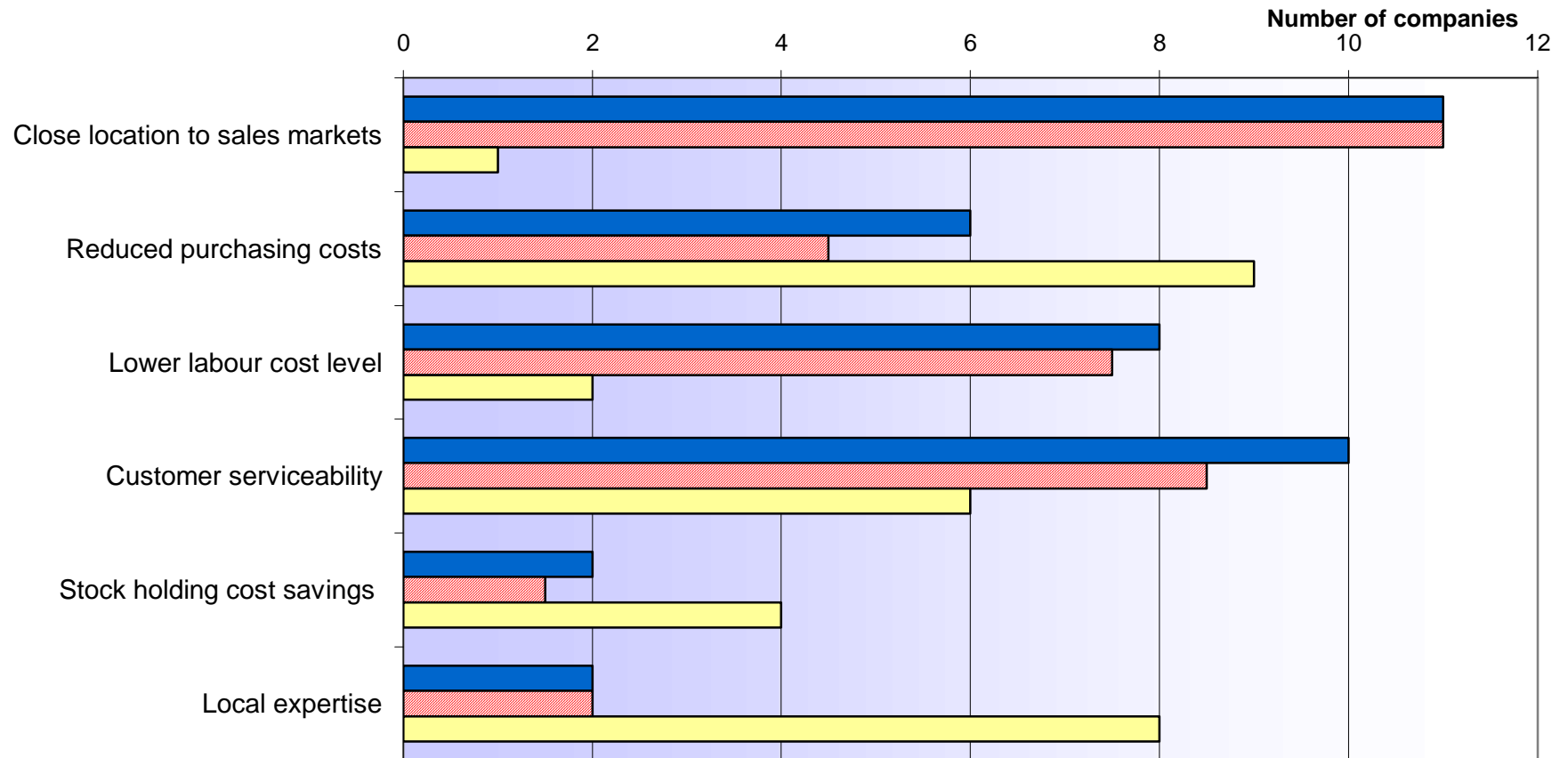
China = 4 (+1)

Asia = 5 (-1)

home markets = 1 (+ - 0)

none i.e. starting = 0 (-2)

## Major expectations, achievements and future targets for business orientation of MNCs operating in China (N=15)



■ Expectations for going into China ■ Nowadays success vs. expectations (success=1, partly=0,5) ■ Future target orientation

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## Complexity of China operations compared to home country operations; Trends

MNCs are for looking to develop next years operations in ...

- Sourcing: from middle level to high \* \* \*
- Assembling: from middle level to high \*
- Engineering: further higher \* \*
- R&D: from non-existing to upper levels \* \*
- Chinese managers hierarchical level: from all levels to middle or high levels \* \*

=> Sourcing and engineering expertise are mostly needed

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## CAGE Framework

- Aim: Comparison of “distance” between countries, markets, etc
- Considered dimensions
  - Cultural Distance
  - Administrative Distance
  - Geographic Distance
  - Economic Distance

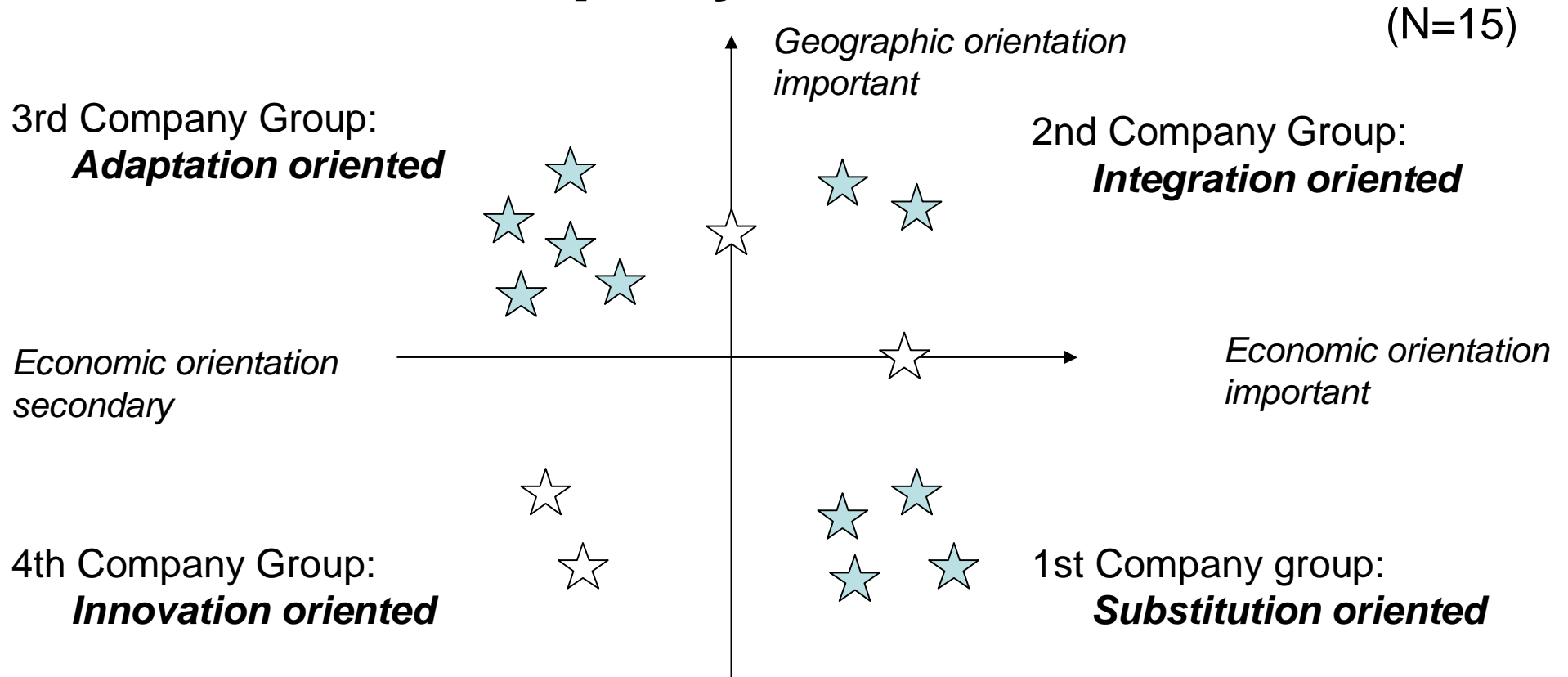
# CAGE Analysis

- What reasons brought the companies to China/Shanghai?

|                                                             | <b>Cultural</b> | <b>Admini-<br/>strative</b> | <b>Geo-<br/>graphical</b> | <b>Economic</b> |
|-------------------------------------------------------------|-----------------|-----------------------------|---------------------------|-----------------|
| <b>Absolute number of<br/>main reasons (N=15)</b>           | 0.5             | 1.0                         | 4.5                       | 9.0             |
| <b>Relative importance<br/>to interviewed<br/>companies</b> | 3.3%            | 6.7%                        | 30.0%                     | 60.0%           |

According to interview results the reasons were normalized to 1.0 (in steps of 0.25).<sup>16</sup>

# Company orientation



☆ = company plant in China can be explained only partly by economic and geographic orientations

☆ = company plant in China can be explained mostly by economic and geographic orientations

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## Results of CAGE Analysis 1/2

- Four segments to classify interviewed companies value-adding strategies:
  - Substitution
    - Cost reduction motives pre-dominant
    - Particular country of operations is of secondary importance
  - Integration
    - Proximity to sales market important
    - Low cost levels of input factors are equally important

## Results of CAGE Analysis 2/2

- Four segments to classify interviewed companies value-adding strategies:
  - Adaptation
    - Being close to customers is most important
    - Cost reduction is side-effect
  - Innovation
    - Differentiate their supply also with cultural and administrative factors
    - Engagement in new market (China) important

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## Questions and comments

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Thank you!

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