

Successful Sourcing Set up in China

One of China's most dynamic regions is the Southern province of Guangdong. With its economic centre, namely the Pearl River Delta, the province is the engine of China's economic growth and has developed into the country's most important export base. In the year 2002, 36% of China's exports worth USD 118.5 billion have been produced here in the year 2002 (*Statistical Yearbook of Guangdong, 2003*). A large percentage of these exports originates from OEM enterprises (Original Equipment Manufacturing), different to many other parts of China, Guangdong is also the home of a large number of private companies, often foreign invested.

Taking all this into consideration, it does not appear as a surprise that many huge retailers can be found in the region. American retail giant Wal-Mart for instance has opened a global sourcing centre in the Pearl River Delta two years ago. Wal-Mart was sourcing Chinese products through this center for as much as US\$ 10 billion in 2002 (*Xinhua, June 2003*). Other multinational retailers such as Metro, Ikea or Carrefour can be found in the region as well, all of them satisfying their global demand of low-price finished products.

However, not only retailers are sourcing from China. The Middle Kingdom has a long record of being the world's leading manufacturer in categories such as toys, air conditioners and televisions, but the range of available products has recently been expanded to hi-tech products such as electronic components. This availability of components and semi-finished products is attracting more and more small and medium sized Western companies.

Besides China's cost advantage, the quality of products made in China and the consistency and reliability of Chinese suppliers have improved during the last years. The fact that multinationals like Intel, Nokia, Siemens, General Electric or Microsoft have localized R&D and manufacturing in China speaks for their confidence in local quality standards and workforce-skills.

Given the advanced globalization and the related cost pressure, many Western companies now face a simple imperative: Source from China and take advantage of the country's abundant manufacturing base and its seemingly unlimited capacity of cheap production, or lose out to your rivals in Europe, the US, Japan or elsewhere.

There are several ways for engaging in sourcing activities in China: Setting up of operations is generally not necessary, sourcing can also be conducted directly by headquarters (e.g. regular sourcing trips to China) or with the help of an external agent. However, sourcing in China still holds a number of challenges: Companies in China have to face communication and language barriers, juridical differences, an enormous complexity of the country combined with lack of transparency. But as one of the most important pitfalls for China sourcing remains the quality

control and assurance - this is especially true for the sourcing of components. The latter but also the other challenges can be dealt with best by having a physical presence in China.

One solution that shall be focused on in the following is the setting up of a representative office in China. Although representative offices are not allowed to conduct business on themselves, they are allowed to search for suppliers and to ensure a constant product quality through factory audits and regular inspections. The drawback is that ordering, signing of contracts and arrangement of payments have to be coordinated and carried out by the headquarters.

Additionally, the representative office provides a company with first China experiences, information and business contacts. This is extremely valuable, especially if sourcing is a starting point only and a mid- or long-term expansion of the China operations is planned (manufacturing/sales in China).

The registration of a representative office takes place at the local authorities and depending on the province takes about 2–10 weeks for the whole process. A China representative office can be realized with a couple of thousand Euro.

In many cases the foundation of a Hong Kong trading company is complementary to a China representative office. This trading company then takes over the contractual relationships with the Chinese suppliers, arranges the payment of goods and coordinates the shipment.

Choosing Hong Kong as a port of call provides Western companies with a safe economic and legal business environment, experienced and English speaking staff, and an extensive logistic and services infrastructure. However, most interesting for Western companies are tax advantages for exports from China: Profits resulting from offshore business are tax-free (Supplier and Buyer are situated out of Hong Kong).

Hong Kong offers another interesting advantage: Finished products bought from China (or elsewhere in Asia) can be “masked” by shipping them via Hong Kong. Thus it becomes very difficult for the end customer to identify and directly contact the supplier. The goods can therefore be shipped directly to the end customer without needing to be detoured to the headquarters.

Finally such a Hong Kong trading company can be set up within a couple of days and with fairly limited investment. A physical presence in Hong Kong is not necessary as most of the trading business (order procession, shipment, and bookkeeping) can be cost efficiently outsourced to Hong Kong service companies.

Contact: Juergen Kracht, Managing Director
Fiducia Management Consultants
Telefon: 00852 / 2523 2171
Fax: 00852 / 2810 4494
Website: www.fiducia-china.com
info@fiducia-china.com

Established in Hong Kong in 1982, Fiducia is a multidisciplinary consultancy focusing on China. With four offices located in Beijing, Hong Kong, Shanghai and Shenzhen, and a team consisting of more than 70 Chinese and Western consultants, Fiducia provides China solutions combining international expertise and local know-how. Fiducia is the partner of AT Consult an international consulting group dedicated to assist clients to overcome challenges in the process of internationalization.