



Flanders
State of the Art

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SOURCING

IN CHINA

FLANDERS INVESTMENT & TRADE MARKET SURVEY



Flanders
State of the Art

SOURCING IN CHINA

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FLANDERS INVESTMENT & TRADE

Omwille van marktcompetitie zijn bedrijven soms genoodzaakt om bepaalde onderdelen, halffabrikaten of afgewerkte producten te gaan aankopen in het buitenland. China heeft zich in de laatste 20 jaar ontpopt als het sourcingland bij uitstek, en staat al vele jaren bekend als 'de fabriek van de wereld'.

Een bedrijf dat met sourcing in China wilt beginnen, doet er goed aan om zich zeer goed voor te bereiden en te informeren. De kans op een financiële kater is immers reëel, en hoe beter men zich informeert, het bedrijf voorbereidt en het goede advies ter harte neemt, hoe meer kans op succes men heeft.

Hoofdstuk 3 beschrijft in detail hoe men zich kan voorbereiden en hoe men mogelijke problemen kan vermijden. Dit hoofdstuk is in het Engels; het is immers een update van de oorspronkelijke Engelstalige gids die Flanders Investment & Trade in 2006 publiceerde.

In het voorjaar van 2011 bracht Voka – Kamer van Koophandel Mechelen een Nederlandstalige gids uit "Wegwijzer voor import & sourcing vanuit China". Bedrijven die van plan zijn om sourcingactiviteiten in China op te starten, of hier nog maar pas mee bezig zijn, raden we aan om deze gids te raadplegen. Dit werk is enkel elektronisch beschikbaar en kan opgevraagd worden per telefoon +32 (0)15 451020 of via email: petra.van.bouwelen@voka.be.

Wij raden bedrijven zonder eigen aankoopkantoor in China aan om samen te werken met een sourcingagent, omdat deze goede terreinkennis heeft, de belangen van het Vlaams bedrijf ter plaatse kan verdedigen, en ervoor kan zorgen dat kleine probleempjes geen grote catastrofes worden. De procentueel kleine kost die dat met zich meebrengt, is het meer dan waard.

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2 NUTTIGE CONTACTEN & INFORMATIE

2.1 SOURCINGAGENTEN

De onderstaande lijst geeft een overzicht van agenten die door onze kantoren gekend zijn en reeds een goede reputatie hebben opgebouwd. FIT kan echter geen garanties bieden of verantwoordelijk gesteld worden in verband met het verstrekken van deze informatie.

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(F) +86-10-63780097

(E) baihui@21cn.com

(W) <http://www.bbldata.com/engsjj.html>

Sinds 1992 actief als import- en exportbedrijf, met een focus op engineeringinstrumenten, automotive componenten en onderdelen.

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(W) <http://www.bftrading.com.cn>

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(W) <http://china.alibaba.com/company/detail/medicinelee.html>

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(F) +86-10-62158012

(E) hrx_trading@hengrunxin.com

(W) <http://www.hengrunxin.com/news.asp?act=content&channelid=11&id=82>

Chemicaliën, machines en apparaten, meubelen, kantoorbenodigdheden, geschenken, beschermingsuitrusting, enz.

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(F) +86-10-67198100

(E) service@baiec.com

(W) <http://www.baiec.com/newEbiz1/EbizPortalFG/portal/html/index.html>

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(F) +86-10-58701217

(E) market@wyattandwang.com

(W) <http://www.sinocubator.com>

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Mevr. Cheryl Tang, Director & GM China

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(T) +86-10-64402106 ext. 222

(F) +86-10-64402672

(E) cheryl@thebeijingaxis.com

(W) www.thebeijingaxis.com

Industriële producten: mijnbouwmachines, afgewerkte producten, apparatuur en instrumenten, elektrische producten, automotieve onderdelen en toebehoren. Grondstoffen: metalen, mineralen, afgewerkt staal, magnesium, aluminium, hout, enz.

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(M) + 32-477-615144

(F) +32-14-720299

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(W) www.horsten.be

Bouwmaterialen, chemicaliën en holglasproducten.

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(F) +86-10-85805080
(M) +86-130-11171326
(E) lucy@highka.com
(W) www.highka.com

Artikelen voor dagelijks gebruik, openluchtproducten, elektronische producten, enz.

2.12 Guangzhou & Shenzhen

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CHINA REPRESENTATIVE OFFICE:
RM 37, Qiaolin Business Center, No.59 Qiaolin Jie, Linle lu, Tianhe District
Zip Code: 510610 Guangzhou, China
Tel: +86 20 3883 9784/ 9794
Fax: +86 20 3893 4095

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(F) +86-755-28732722
(E) Steven.Yan@bssourcing.com
(W) <http://www.bssourcing.com>

Opgericht in 2000, is gespecialiseerd in auto-onderdelen, verlichtingsproducten, huishoudelijke apparaten, bekers, lederen producten, enz.

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(F) +86-20-86182992
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(W) <http://www.dqmchina.com>

Opgericht in 1998, is gespecialiseerd in opgerolde kabels en kabels voor de automotive sector, routers, zonnepanelen, buiten, elektriciteitskasten.

LUCAR ASIA CO. LTD.

Dhr. Gianluca Zoppa, Mevr. Kristy Zhang
Room A1502, Shangde Building, 141 Wushan Road, 510635 Guangzhou
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(F) +86-20-38471692
(E) info@lucar.net

Opgericht in 2001, is gespecialiseerd in staal- en kunststofproducten.

MERIT TECHNOLOGIES & EQUIPMENT LIMITED

Dhr. Han Vugts

Asterstraat 12, 7004 BV, Doetinchem, Nederland

(T) +31-61-8948861

(E) sales@merit-china.com

(W) <http://www.merit-china.com/en/index.html>,

http://www.bizearch.com/company/Merit_Technologies_Equipment_Hongkong_Ltd_78230.htm

Is sinds 2002 actief in sourcing, vooral gespecialiseerd in het inkopen van grote volumes plastic en aluminiumfolie.

VANTRONIX SOURCING INTERNATIONAL CO., LTD.

Mevr. Evian Luo

7B, Building 6, Zhong Hai Li Yuan, Nanshan Blvd 1006, 518054, Shenzhen

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(F) +86-755-26059526

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(W) www.vsisourcing.com

Opgericht in 2008, is gespecialiseerd in elektronische componenten.

GUANGZHOU HOMFEL LTD.

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T: 86 20 39239634 ext: 606, M: 86 13560049578, E: martin@homfel.com, W: <http://www.homfel.com>

Bad- en keukengerei

WRIST SHENZHEN TRADING CO LTD

Contact: Mr. Daniel Van den Berg

2nd F, Qian Qi Logistic Warehouse, No. 1038, Mao Gang Road, Huangpu District, Guangzhou, China

M: 86 13066353524, E: dabe@wrist.com, W: <http://www.wrist.com>

Alles behalve provisie

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Contact: Mr. Charlie Chan

Unit E, 3rd F, Building 1, Fu Rong Tai, No. 183, Pingxin North road, Pinghu Street, Longgang District, Shenzhen

T: 86 755 89205789, F: 86 755 84196795, M: 86 18926408841/13662266273, E: charliechan@stusupplychain.com,

W: <http://www.stusupplychain.com>

Consumentenelektronica, machines, legeringen

GUANGZHOU KS TRADING & FORWARDER CO LTD.

Contact: Mr. Edward Lu

No.32-04/07, Onelink Plaza, Jie Fang Nan Road, Yuexiu District Guangzhou

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2.1.3 Hongkong

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(E) alex@creser.com

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Dhr. Jeremy Lancksweert, General Manager
Dhr. Jean-François Destexhe, Director
22/F, Siu On Centre, 188 Lockhart Road, Wanchai, Hong Kong
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(F) +852-25647721
(E) jeremy@greendelta.com.hk / jfd@greendelta.com.hk

Huishoudproducten, keukengerei, decoratie, elektrische producten en elektronica, alsook kwaliteitscontrole en productontwikkeling.

PORT CITIES LTD.

Dhr. Philip Van Remoortere, General Manager
Rm 1902, Hua Fu Commercial Bld., 111 Queen's Road West, Sheung Wan, Hong Kong
(T) +852-23671735
(E) philip@portcities.net
(W) www.portcities.net

Algemene producten, meubelen, elektrische en elektromechanische producten en elektronica, alsook kwaliteitscontrole en productontwikkeling.

2.1.4 Sjanghai & Hangzhou

A.G.C. BUSINESS CONSULTING S.A.

Dhr. Boris Boullot, General Manager
Rm 16D, Yujia Mansion, 168 Pingwu Road, 200052 Shanghai
(T) +86-21-62486110/8722/9976
(F) +86-21-6248 3351
(E) boris.boullot@asiaglobalconsulting.com
(W) www.asiaglobalconsulting.com

Technische componenten voor machines en apparaten in verscheidene sectoren.

ChESS – China Europe Strategy Solutions

Jennifer Lu, CEO
Building 21, Room 103, 498 Guoshoujing Road, , Pudong New Area, Shanghai
(T) +86 21 20221266
(F) +86 21 50276656
(E) Jennifer.lu@chess-nv.com
(W) <http://www.chess-nv.com>

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The China Office

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Room 2012 A, Diqu plaza, No. 666, Tai Kang Middle Road, Ningbo
(T) +86-574-82833920
(E) nicolas.thys@the-china-office.com
(W) <http://www.the-china-office.com/>

Promotional product companies

WANG FAT INTERNATIONAL / ProHub ENGINEERING

Dhr. Filip Duthoy, General Manager
Unit 407, Block 15, Huqingping Rd No 2799, Qingpu district, 201703 Shanghai
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(W) <http://www.prohub.com.cn>

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(E) james.yang@pintuu.com
(W) <http://www.pintuu.com>

Machines en robotics, electriciteitsdistributie en consumptive, medische hulpmiddelen, gereedschappen, nieuwe energie, clean tech.

2.2 WEB LINKS

- Landendossier China – Flanders Investment & Trade
<http://www.flanderstrade.be/site/wwwnl.nsf/landendossiershome?openform>
- Canton Fair
<http://www.cantonfair.org.cn> – grootste handels- en sourcingbeurs in China
- Alibaba
<http://www.alibaba.com> – platform voor aankopers en leveranciers
- Made in China
<http://www.made-in-china.com> – platform voor aankopers en leveranciers
- Hong Kong Trade & Development Council
<http://www.hktcdc.com> – informatie over sourcing en leveranciers
- China Sourcing
<http://en.chinasourcing.org.cn> – informatie over sourcing en leveranciers

3.1 INTRODUCTION – BEFORE YOU GET STARTED

This report targets Flemish companies who may be looking to source in China. Nicknamed 'the factory of the world', China appeals to any company looking for cheap raw materials, components, semi-finished and finished products. However, due to recent rising production costs, to some China is not the low-cost production paradise that it once was, and we already see a trend whereby companies start looking at neighbouring countries such as Vietnam for better sourcing conditions.

This report will give you an overview of the challenges and opportunities that come with sourcing in China, and it tries to guide you in your choice of setting up a sourcing office in China or going through a sourcing agent.

Sure enough, your company can choose to pay regular purchasing trips to China, but we do not consider this to be a good choice, unless you are purchasing standard products that have been mass produced already. Any other product requires a more committed approach. Another thought that comes to some people's minds, namely to source directly online, through e-mail or by fax, seems to us a secure way to end up with a serious financial and psychological hang-over. Indeed, the dangers involved in trying to get products as cheap as possible by dealing directly with suppliers, without any quality supervision system in place, are fairly obvious.

3.1.1 Frequently Asked Questions

Why should I consider sourcing in China?

If you are looking to cut production costs or want to spend less time on production and more on sales and marketing, then you may want to look at what China can offer. Almost any manufactured item can be sourced in China. The ones that will provide the most savings are those with high labor and raw material content, and relatively low transportation costs (low weight and volume).

What products/industries are best suited for sourcing?

The pioneers of the sourcing trend were sport shoes and garment manufacturers, and the computer industry. Many major international consumer goods makers and traders have substantial sourcing activities in China, be it in garments, shoes, white goods, brown goods, etc. China has long been the world's leading manufacturer in categories such as toys, air conditioners, motorcycles and televisions.

But in recent years the opportunity to source in China has expanded to include high-tech products such as electronic components. As China has moved up the value chain, now an increasing number of manufacturing companies in the technical field follow the sourcing trend. They are buying parts and components in China that flow into the manufacturing process in their home country. Sourcing for components and semi-finished products is now quite popular.

What's more, in some sectors more and more European factories are starting to buy finished products in China. There are two reasons for this: quality is increasingly reliable and they find it more and more difficult to compete back home by just sourcing semi-finished products from China.

The best products/industries for sourcing in China are those where you can exploit the advantages of purchasing in China and where the impact of the disadvantages is small. Here are some factors to consider:

1. Little upfront design work needed; avoid highly specialized design with critical processes
2. Stable design (long product lead times, low variability, low degree of customization)
3. Cost of item usually greater than 5 €
4. High Mechanical/Electrical Engineering Content
5. High Labor Content (e.g. more than 25% of the product cost structure)
6. Large number of a few stock keeping units
7. Low freight costs (low weight & volume, high packing density)
8. Large raw material content (locally sourced from competitive suppliers)

9. Obtainable technology
10. Initial order greater than 50,000 € (after sample order), unless the product is already under production

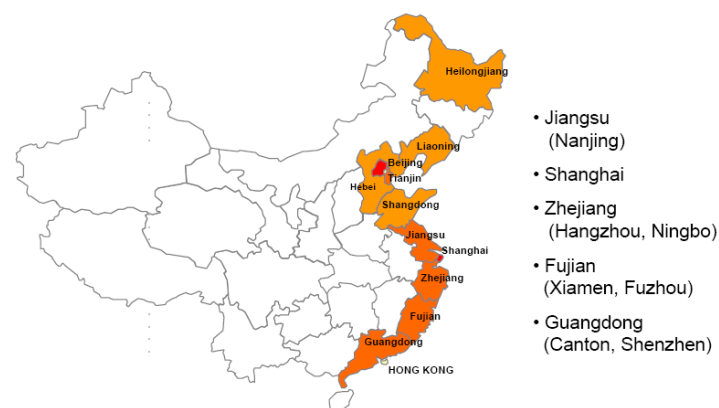
Currently the main industries for sourcing in China are:

- Textiles, Garments & Silks: the world's top textile exporter produces good quality at low costs.
- Arts & Crafts: produced by thousands upon thousands of small local companies.
- Light Industrial Products: good quality thanks to the use of imported machinery.
- Chemical Products: China is one of the world's major exporters of chemicals.
- Machinery, Equipment, Hardware: okay quality for low price, but do not expect world-class standards.
- Optical & Electronic Products: good price-quality ratio.
- Foodstuffs: cheap production costs, but can be risky if not managed well (cf. recent media articles).

In recent years Chinese suppliers have upgraded their production processes substantially. The opportunity to source in China has expanded to include high-tech products. Telecom, biotechnology, and electronics are emerging new strengths. However, while some foreign companies are already sourcing highly specialized manufactured sub-components made with custom equipment, they do keep their core technology outside of China, due to intellectual property rights issues.

Where in China should I do my sourcing?

This depends on the product you want to source, its technical specifications, the importance of transport costs in your sourcing process, and so on. Generally speaking, the East and South of China are the hotspots of sourcing, with the provinces of Jiangsu, Zhejiang, Fujian and Guangdong being the 'factories of the world'.



Shanghai – Jiangsu – Zhejiang

Shanghai is the modern thriving hub of business in China, and many overseas companies naturally think of it first as they consider sourcing products in China and/or locating a factory there. The fact is, however, that Shanghai has already become a somewhat expensive place to do business and although many Chinese companies maintain offices there, most factories in the area are likely to be located in one of the two neighbouring provinces – Zhejiang or Jiangsu.

Shanghai has always been the nation's gateway for import and export and also the largest economic centre in China. Shanghai has significant advantages for sourcing and logistics since Shanghai is the site of the major port for the area and containerized shipping can therefore be easily arranged as local transportation from the factory to the port is relatively of low cost.

Guangzhou/Guangdong – Fujian

The South of China has long been the region where entrepreneurship has been given free reign. As a consequence the region started its privatisation drive much earlier than the more bureaucratic North, and hundreds of thousands of small and medium-sized private enterprises were set up in the 90s. Many of these companies were quite successful, and have been at the centre of what the world media now call 'the factory of the world'.

Guangdong Province and its economic centre, the Pearl River Delta, is the engine of China's economic growth and has developed into the country's most important export base. The majority of these exports originate from OEM enterprises (Original Equipment Manufacturing).

While your future supplier will therefore most likely be located in the East or the South, this is only really a factor when you do the sourcing yourself. When looking for a sourcing agent other issues play a more important part, like quality of service, open communication, reliability, and so on. The distance between the sourcing agent and the supplier may affect travelling costs, but these will be of minor influence.

Should I go through a sourcing agent or set up my own sourcing operations?

Most Flemish companies do not have a choice, because they just don't have the means to set up their own operations. While the easiest choice is going through an agent, there are a number of reasons why you may want to set up your own operations: your company's long-term sourcing strategy, high purchasing volumes, combination of sourcing and selling, high technical requirements for quality control, etc.

In any case it is advisable to consider both possibilities thoroughly before deciding what is best in the long run.

Note that some China-based sourcing companies can, in the long run, potentially become a local representative of your company in China. As such these companies can bring substantial savings to your company's overhead costs.

How do I request a sample item to be quoted in China?

If you are interested in having your product(s) sourced in China, you would do best to supply three sets of the following to the potential sourcing agent or supplier:

- Samples
- Drawings (put in place safeguards to avoid IPR violations by supplier!)
- Technical requirements and raw materials used
- Volume in units
- Lead time requirement in term of shipments
- Quality inspection procedures
- Packaging requirements
- Target cost (optional)

How long does it take?

This depends on whether you are sourcing a product that is already produced in the market, or are looking for a specific product according to your own design. For items that are already on the market, lead times can be less than 4 weeks; for simple products where the design and samples are available, you can expect from 1-2 months. The more complex the project, the longer it will take.

Working through a reliable sourcing agent will cut lead times, as they have everything in place to find the right suppliers quickly. If you want to do develop your own sourcing structure, it may take up to 12 months to start sourcing successfully.

How much does it cost?

This depends on how, how much and how fast you want to source. A sourcing agent will either charge a commission of 2-15% of the value on the invoice, or work for a set fee that involves longer-term projects. Such fee may start at 1,000 USD and go up to 25,000 USD or more, depending on the difficulty, volume and length of the project. Still other sourcing agents will offer a combination of both.

If you want to set up your own sourcing infrastructure, there will be the costs of setting up an office, searching for suppliers, ensuring quality, and so on.

How are goods quoted and paid for?

This depends on how you do your sourcing; if you work directly with the suppliers, then you can work out the quote and payment details among each other. When working through sourcing agents most product quotes are presented CIF to the required delivery port. The final offer would probably include all manufacturing costs, shipping costs, and the fee or commission that the agent charges.

Other costs include handling, tariff and/or tax charges, local customs clearance and delivery, to be paid directly or through the agent.

In the first instance, transactions will be secured with an Irrevocable Letter of Credit. Later, when a strong relationship is built with a supplier other arrangements can be made. L/C's can be complicated and expensive to administer, and some purchasers prefer T/T payment or other methods; all these can be negotiated with the supplier or the sourcing agent. However, always make sure to talk to your own bank first to discuss all this.

How difficult is it for me to travel to and in China to conduct business?

Travelling to China is easy; there are many flights from Europe to Beijing, Shanghai and Guangzhou every day. It is necessary to obtain a visa to enter China. We suggest that you apply for a tourist visa, as this is the simplest and most straightforward way. Normally it takes between five and seven days to get the visa, but you can ask for an 'express' delivery (2-3 days) at an extra cost.

For a business visa you will need an invitation letter from a company that is registered in China and that has the right to send an invitation letter. If you plan to visit China more than once within a relatively short period of time, you should apply for a multiple entry visa, and your inviting party will have to give arguments for this in their invitation letter.

China is a modern country with very efficient means of transportation and accommodations for travelers. However, many manufacturers are located in more remote areas (which is why they are cheaper), where travel issues can be a problem if you do not speak Chinese.

In any case, it is highly recommended that you either let your sourcing agent or supplier take care of the local travel arrangements, or go through a travel agent who can do the same.

3.1.2 Pros and Cons

Many companies now look at China as a way to obtain raw materials, semi-finished and finished products cheaply. However, before you decide whether purchasing from China is the best decision, you need to look at more than just the manufacturing cost of the sourced product; transportation efficiency, lead time and scheduling stability, product design, and technical capabilities all come into play..

What exactly are the advantages and disadvantages of sourcing in China?

- Pros -

- China's relatively low manufacturing cost:
 - Low overhead costs (rent, utilities, taxes, product design, R&D...)
 - Low raw and processed materials cost
 - Low labour cost (average wages approximately 100 € per worker per month)
 - Flexible working conditions
 - Large supply of low-cost labor
 - Labor savings are best realized in manual operations
- Comparatively good quality output:
 - Highly trained, motivated and literate work forces
 - Improved productivity, quality and product sophistication
 - Substantial export experience
- Business-friendly environment
 - Manufacturer-friendly governmental policies

- Stable economy and currency
 - Established and dynamic industrial infrastructures
 - Flexibility of suppliers (open to supplier development, use new techniques, etc.)
- Sourcing as a starting point for future China activities: sourcing can be the starting point for expansion in China, providing for the development of specific China competence, laying the foundation for your own production in China as a possible goal.

- Cons -

It is imperative to be aware of all the factors that can affect the bottom line. Often, the hidden costs of sourcing are not taken into account, and, if not managed well, may be devastating to your company (think late deliveries, wrong or shoddy products, lawsuits, etc.).

Good quality sourcing takes a lot of time, resourcefulness, and attention to detail. It is hard to calculate those costs, but costs they are.

- General difficulties of sourcing and global trade:
 - Difference between a company producing a good product and being “export ready”
 - Lack of experience exporting to big key markets abroad
 - Global sourcing dynamics: a good source today may be not so good six months from now
 - Good quality sourcing research requires a big amount of time and money
- China’s distance to Europe:
 - Higher transportation costs, incl. duty and freight costs
 - Potentially higher cost of inventory because of long supply lines
 - High inventory and defect risk due to purchasing in large volumes
 - Personal travel time
 - Time difference (telephone calls, jet lag)
- Cultural differences between China and Europe:
 - Language and communication problems
 - Negotiations: Chinese are smart, shrewd business people and tireless negotiators
 - Loss of intellectual property: ‘anything that can be copied will be copied if there is a market for it’. It might be a good idea to keep to yourself proprietary processes in your operation that cannot be detected by disassembling your product, but which have a major impact on the end performance.
- China is still a country in development:
 - Sometimes substandard product design
 - Limited access to raw materials or secondary operations

3.13 Dos and Don’ts

Most of the following reminders are common sense guidelines that can and will save you time and aggravation, and that will help to eliminate misunderstandings and the potential for unexpected costs. Sourcing products overseas is not simple but neither is it so complex as to be beyond even the smallest companies.

- Dos -

- Establish a sound sourcing strategy and communication channels between head office and China.
- Use outside options: sourcing companies, quality monitoring specialists, freight forwarders, etc.
- Investigate the sourcing company you plan to work with: do they understand the product, the suppliers, etc.?
- First sign a Non-Disclosure Agreement (NDA) with your sourcing company. Insist on confidentiality and protection of all information about your company, the product and all aspects of the sourcing

exercise. Once the NDA is signed, give the sourcing company as complete an understanding of the project as prudently possible and what you want accomplished.

- Give or jointly draw up with the sourcing company a written scope of work stating goals, time table, price, agreed milestone targets and a designated final product (written report or other).
- Ensure stringent quality control during all phases of the project: design, production, delivery.
- Expect to pay part of the agreed fee for service up-front. Most sourcing companies incur costs from the start of work and won't front these costs unless for major clients with long-term contracts.
- Provide written drawings, specifications and other documents of products to be sourced. Explain to the sourcing company key issues from your company's perspective that will be used in selection so that you and they are focusing on the same key issues.
- Expect to travel to China a couple of times to keep the communication channels open, to inspect production on-site and generally to solve small problems before they become big ones.
- Consider the effect of inspections, shipping charges, customs fees, and so on. These issues are also vital to your project's success.
- Realize that sourcing takes time. Don't expect an immediate solution to be necessarily the best solution.
- Keep an open mind. Sometimes the solution you are thinking of may not be the best one. Oftentimes a full review of options may take you somewhere you had not considered at first.
- Do realise that any long-term business relation can only work on a win-win basis. A Chinese supplier will only be willing to work with you, and stay working with you, if they feel that they get a fair share of the deal.

- Don'ts -

- Do not focus on the lowest price; quite often the lowest price is an invitation for problems later on.
- Don't expect the sourcing company to do your sourcing to work on auto-pilot. Stay interested and communicate.
- Do not undertake the trip to your supplier by yourself, unless you speak perfect Chinese and are an old China-hand. Engage an experienced professional (e.g. the sourcing company) to assist you. Secure this help early; be open with them about your goals and key factors, and listen to their recommendations.
- Do not hurry things, as mistakes can cost you plus possibly break relationships that could be valuable in the long-term to you and your company.
- Do not trust your suppliers too much; do not pay up front for the sixth delivery, even if your supplier asks you to do so, and even if the first five deliveries went smoothly. Enough foreign companies have made this mistake, only to realise that the supplier had been counting all along on making a fair profit (at least in their eyes) from their business relationship with you.

3.14 3.14. Your role as a customer

Before you start to look for suppliers and/or sourcing agents, please be aware that these companies, just like you, have certain expectations of their potential customers. Indeed, everyone is trying to do good business, and this involves an effort on all sides of the business relationship.

Here's a shortlist of what your sourcing partner in China expects from you:

- A solid reputation in your home country; honesty and credit-worthiness are necessary;
- Good and efficient communication is a must; this is often a problem of European companies;
- Be ready to work on a basis of bilateral benefit;
- Most prefer a long-term approach, while some can work on a single project;

- Be clear about what you want to purchase (product requirements, etc.);
- Be ready to come to China and visit potential manufacturing plants;
- Be flexible enough to understand Chinese material standards and production processes;
- Opportunism is not welcomed; you need to be committed and not focus on price only.

3.2 THE SIX SOURCING COMMANDMENTS

The issue of sourcing in China is a complex one, and as a purchasing company you will be faced with many opportunities and many challenges at the same time.

We asked a number of sourcing companies what they considered to be important in the sourcing process. Their answers give you an insight into the many risks that may be involved, and will hopefully help you to make the right decisions.

3.2.1 Be present in China or get assistance

The keys of a good sourcing project in China is having someone permanently in China, to learn about the local technology level and production capabilities, to visit and establish a close relationship with the factories, to control the goods, and to know the new market opportunities right when they arise. If this is not possible, especially in the beginning stages of your sourcing activities, then work with a sourcing company.

A reputable sourcing company can eliminate unnecessary risks concerning quality and delivery dates, as well as avoid fraudulent activities of the supplier. They can also help you control the manufacturing process in the Chinese factories, and bridge the gaps between your needs and the supplier's capabilities.

In short, a good sourcing company will save time, money, and deliver quality merchandise. You can focus on design, marketing, distribution of goods, and not worry about production. After all, that's what you're paying them for.

3.2.2 Be in control

You need to be in control every step of the way. Regular visits by yourself or your agent at the supplier's factory are a must; a quality control and process review system needs to be in place. Communication channels with the supplier, either directly or through your agent, need to be open and smooth, so as to avoid misunderstandings.

In case the products are complex or you want to avoid risks, the best thing is to send a technical expert from your company to the Chinese factory during the whole production process and final quality inspection.

3.2.3 Focus on reliability & quality rather than on price & friendliness

There are hundreds of thousands of potential suppliers in China. It is imperative that you choose a reliable supplier who can produce quality products.

Do not be fooled by cheap price quotes, wonderful promises, intoxicating flattery and warm-hearted wishes for mutual cooperation during exquisite banquets; look beyond the smiles and check out the company's reliability, years of experience, export countries, production volumes, quality tests and quality control (this can be done through agents, consultants or banks).

Be ready to check out ten suppliers before finding the right one.

3.2.4 Prepare for the worst in order to avoid it

What happens when things go wrong? Sure enough, many foreigners have fallen and are still falling into the Chinese wining and dining trap, only to discover that when things do go wrong even the seemingly most sophisticated Chinese factories become blind to ethics and contracts in the face of their wrongdoings.

The great friendship and trust that marks the beginning of the relationship with your Chinese supplier often translates into bad contracts and even worse dispute clauses. Spell out from the start what is acceptable and what not, and what the consequences are in case the parties deviate from the contract. Consistently use product quality guarantees. Make sure that your dispute settlement mechanism is clear and that it allows for a fair settlement – the Chinese judicial system tends to favour the Chinese side, but a good sourcing agent can help avoid this problem.

We cannot stress enough that you need to acquire the expertise of local sourcing agents, consultants or lawyers concerning the possible pitfalls of the Chinese judicial system, especially in the initial and contract phases.

Having said this, there is another important way to help avoid trouble: to build up a strong relationship with your supplier.

3.2.5 Build up a strong and long-term relationship with your supplier

Chinese people are generally very friendly and eager to do business with you. In the course of your business talks, they will want to establish a kind of personal friendship which goes beyond pure business. They will invite you for dinner, maybe for a long evening of drinking, and in a later stage, when you have become 'old friends', to their home. Do not say 'no' to this, and kindly accept this way of getting to know each other better.

This Chinese type of 'friendship' is important because Chinese people make a very strong distinction between people whom they know as friends and relatives, and everyone else. In general Chinese people will do anything for their friends and family. However, in public and on the street they don't really care about what happens to strangers. The respect that a Chinese person has for someone else derives from their mutual acquaintance, and not from the mere fact that they both are human beings. As such, Chinese business people want to make sure that you are friends, which implies that you will respect and not deceive each other.

Making sure that the supplier feels comfortable with the business deal is another aspect of building up a solid relationship. So while you try to get the best deal you can for your own company, you must be aware that cutting the supplier's profits too much will lead to problems in the long run. At first the supplier may not say anything; but it is not inconceivable that one day the supplier, with whom you have worked for more than a year, convinces you to pay for a large shipment in advance, and that the shipment never arrives.

Do share with your local supplier your knowledge, experience and profits. A win-win situation for both purchaser and supplier will foster a long-term relationship.

The same goes for your sourcing agent. Trying to negotiate a very low commission or fee will not promote a long-term relationship. Actually, most reliable sourcing companies are doing good business and are not inclined to work with you if they feel that you want to scrape every cent out of a deal. Be reasonable and accept the going rates; sourcing companies who accept much less than that may have less to offer.

3.2.6 Be patient, flexible and creative

China and its people are complex, to say the least. What at first seems simple often turns out to be quite difficult. In a society where children are taught certain things, only to discover, as they grow up, that reality can be somewhat different, it is difficult to find people who are completely straightforward. Getting correct information is quite hard, and it is very difficult to know what people are thinking or how they will perform.

It is therefore important that you take time to learn how things work, and how you can get things done. When making up a plan, make sure to include a section entitled 'unexpected', as the unexpected is the one thing that you can expect to happen.

Successful sourcing in China requires a lot of time and effort, and things may not always go according to plan. Be patient and flexible, and don't hesitate to come up with creative ways to solve a problem.

3.3 SOURCING OPTIONS

There are three options for sourcing in China: you can organize regular buying trips, set up a company in Mainland China or Hong Kong, or work with a sourcing agent.

3.3.1 Regular buying trips

You can visit Chinese fairs, like the Canton Fair in Guangzhou, and travel the country looking for potential suppliers; you can search online supplier databases (websites where you can find Trade Leads, an e-Catalog and a Company Directory). In any case, visiting your potential suppliers is a must.

- Advantages: no specific set up costs, straightforward, best-suited for sourcing finished products.
- Disadvantages: difficult quality control and assurance, definitely not good for design-specific products.

A good event to check out what consumer goods are available in China is the Chinese Export Commodities Fair in Guangzhou, also called Canton Fair, the largest of its kind in China. Held twice a year (in April and October) it attracts hundreds of thousands of business people from over 200 countries. Billions and billions of dollars of business deals are made during this feverish and blatant display of global consumerism.

3.3.2 Setting up a company

It is possible to establish your own wholly foreign-owned purchasing operation, although the capital requirements may be rather high. Alternatively, you can set up a Trading Company in Hong Kong with a representative office in Mainland China. Most foreign companies work this way. The rep office is in charge of sourcing and inspection/quality control, and is closest to the suppliers. The trading company takes care of the contractual relationship with the suppliers, purchasing and shipment coordination (tax advantages, clear import/export procedures).

- Advantages:
 - › Relatively small setup, an ideal starting point for operations in China;
 - › Experienced staff in Hong Kong for trading operations;
 - › Well-developed infrastructure;
 - › Free currency inflow/outflow;
 - › Lower risk – easy market exit possible.

- Disadvantages:
 - › You cannot buy/trade directly in China, as rep offices have no trading rights;
 - › Control issues: special attention is required for coordination and communication.

3.3.3 Working with a sourcing agent

Lots of sourcing companies offer their services to foreign companies wishing to buy products in China. When looking for a reliable sourcing agent, you may want to look at some of the following aspects to determine whether the company you are in contact with is suitable for you:

- Track record: generally speaking, companies who have been around for a few years tend to be those who have proven their quality and trustworthiness. These companies may have started out with one happy client, who then referred them to another client, and so on. Gradually they become more experienced and efficient, and thus more reliable for the purchaser.
- Management: it is our experience that companies with a foreign (European) management tend to be easier and smoother to deal with. Not only does the foreign manager understand your business culture better, but s/he also grew up in the same society and has likely developed the same kind of business ethic. It is important to know that Chinese business ethics are different from European ones, and these differences may lead to costly and painful misunderstandings. Still, many young Chinese business people have become quite accustomed to the Western way of doing business, and you should be able to find a Chinese sourcing partner who understands your needs perfectly.
- Specialization: your agent should know the products, the factories, the trends and the individuals behind the factories. As the sourcing industry is becoming more mature and more competitive, the well-established sourcing agents have begun to specialize in certain sectors or products. It pays to look for such specialists.
- Transparency: a good sourcing agent is not afraid to work in a very transparent environment where you have full disclosure of OEM and product information. Be wary of agents who want to keep you in the dark.
- Focus: in the past and even now many Chinese-managed sourcing companies said that they can source any product that you need. While this may be okay for finished mass products or if it is a very large sourcing agent who can cover almost every sector, you may prefer to work with a company which works with a limited number of products with suppliers that they've known for a while and trust.
- Quality (control): how important does the sourcing company consider quality control, and what quality control systems do they have in place? While this is difficult to know at first hand, unless you know people who have worked with them before, you may be able to find clues in the way the sourcing company communicates with you; do they seem professional and efficient, do they paint a balanced story of opportunities and risks, etc.?
- Price level: "There Is No Such Thing As A Free Lunch". We would therefore suggest that you be wary of companies who offer very low fees or extremely competitive prices that seem too good to be true. The market has become mature enough in order for there to be a proper balance between price and quality. Paying less for a service means that you will get less of a service.

Through our contacts with a wide range of sourcing companies we have come to believe that most of them are capable and reliable. The challenge for them and for you is to see how the production and delivery processes are managed. In Chapter 2 there is a list of companies and organisations with whom

we have been in contact. Please note, however, that our offices have never personally done any sourcing business with them, so we cannot give you any guarantees.

3.4 SOURCING PROCESS

3.4.1 Searching for suitable suppliers

Whether you are working with a sourcing agent or are doing the sourcing yourself, you will need to do some thorough research on potential suppliers. You may have found a long list of potential suppliers from an online database, and now it's time to make a short-list.

What makes a suitable supplier suitable?

- Quality: do their products inspire confidence in terms of quality?
- Client reference / Export history: what are their current target markets? To which companies have they supplied in the past?
- Flexibility: can they match customers' order volumes and technical requirements?
- Well-managed: has the company developed a proper management and production process? Is it able to meet delivery deadlines?
- Cost effectiveness: can they offer competitive prices while maintaining quality?
- Corporate social responsibility: does the company act in accordance with CSR values?

Seeing as there are many potential suppliers for your products out there, you can be picky and patient. In short, you should feel comfortable about every single detail of your business requirements before deciding on your supplier.

3.4.2 Sourcing process

The sourcing process involves two or three parties: the customer, the supplier and, if applicable, the sourcing agent. For reasons of convenience we will assume that the sourcing company is involved; if you do not make use of a sourcing company then you will be responsible for whatever aspects of the sourcing process that they normally take care of.

	Activity	Customer	Agent	Supplier
Search	Define product specification and packaging			
	Define supplier criteria			
	Supplier search			
	Pre-selection – check qualification of suppliers			
	Shortlist			
	Factory visit and audit			
Test – Contract	Sample evaluation			
	Test order			
	Contract			
Supply	Quality assurance			
	Quality control			
	Supply chain management			

Source: [Fiducia](#)

Search Phase: the customer and sourcing agent exchange information about the product's specifications, how it has to be packaged, target prices, shipping conditions, and so on. Next you discuss what kind of supplier you are looking for. After a thorough supplier search (suppliers need to be contacted and asked about their technical capabilities and prices) you shortlist some of the most promising companies. You visit these companies, and decide to choose one (or several of them) for sample testing.

Test/Sample Phase: during the sample phase it is important to give the supplier enough technical support so as to avoid misunderstanding. Indeed, at first the supplier needs to learn what your needs and requirements are, and needs your feedback in order to do so.

Contract Phase: negotiations have to be based on mutual respect and benefit for them to succeed. Make sure you discuss all the details of your future cooperation, such as volumes, pricing, quality and management system controls, etc. At the same time you need to leave room for future adjustments to the contract.

Supply Phase: regular visits to the factory are necessary so as to avoid problems. A process assurance audit will be done to ensure a stable process and quality. Review and update all the open issues. Prepare for packaging and logistic issues. Make sure to have an inspection system in place during each step of the supply chain.

3.4.3 Quality control

Quality control is a key element to successful sourcing. It can be done by yourself or the sourcing company; at the time of shipping you may want to request the services of an internationally-recognized quality control company.

It is important to have regular inspections during production, so that you can catch mistakes and adjust things. It is very difficult to find a solution AFTER production is finished. Having to repeat production, or simply missing delivery dates will be very costly.

Below is a list of control procedures that you should expect to implement, or have implemented by your sourcing agent (list provided by [Merit Technologies & Equipment Hong Kong](#)):

1. Detailed instructions to the supplier; including
 - a. *Quantity of products*
 - b. *Drawing references*
 - c. *Sample references*
 - d. *Specification sheets*
 - e. *Dimensions of product*
 - f. *DIN / ANSI / ASME references*
 - g. *Pressure ratings*
 - h. *Thickness of material*
 - i. *Material*
 - j. *Required finish*
 - k. *Packaging; number of units per ...*
 - l. *Type and quality of packaging material*
 - m. *Labeling*
 - n. *Any other agreed requirement*
2. Technical instructions; including
 - a. *Strength of materials*
 - b. *Chemical composition of material*
 - c. *Finish thickness; smoothness, quality*
 - d. *Hardness*
 - e. *Other requirements*
3. Quality Control
 - a. *If in place: the certified quality control procedures and standards by the supplier*

b. If not in place: all optical aspects of the product, all measurable dimensional requirements of the product; not requiring special tools or equipment, the supplier will be instructed to adhere to the quality control procedures of the sourcing agent

4. Frequency and quantity of control

- a. First order should be controlled at random during and at the end of the production process;*
- b. Depending on the quality procedures installed, the volume of individual orders, the value per ordered item, subsequent orders will be controlled at random quality inspections in-line and end-line;*
- c. All orders should be inspected before shipment*

What the sourcing agent may not do:

- Controls requiring special tools or equipment;
- Laboratory tests;
- Tests executed by specialists or external certifying bodies, such as SGS, TÜV, Lloyd's etc.

3.4.4 Sourcing agents

Sourcing agents in China are compensated in a variety of methods. The majority work on some form of commission. Commissions generally can range from 2-15% of purchase value, depending on the number of services that you require; this is not unreasonable when the savings generated can double that amount. The problem with working on a commission is that the agent has less motivation to decrease the price.

Another compensation option is a percent of savings scheme where payment to the Sourcing Agent is based on your savings. This is difficult to arrange, as it requires full disclosure from all parties. Furthermore, your agent will now be inclined to advocate for whichever factory has the cheapest price. Often this is not the best price/quality ratio for your given target price.

The third option is to work with a fixed fee, either for one single project or on a monthly basis. This seems to align the buyer's and sourcing agent's interests: under this method the sourcing agent's job is to get the best price/quality ratio possible based on the buyer's exact needs. An arrangement of this type with a trusted agent who has a presence in the local market is of great value and provides peace of mind to the customer. This option will lead to a long-term relationship built on mutual understanding rather than one-off commission-based deals or legal documents (like letters of exclusivity) that mean very little in the reality of China. The agent's job is to make sure you remain profitable and are a happy customer. Project fees generally start from 1,000 and go up to as much as 25,000 USD or even more, depending on the complexity and size of the project.

3.4.5 Sourcing costs

It is rather difficult to specify what the total costs of sourcing will be, but here is a short overview of the major costs involved.

- Setting up a legal representation in China: please refer to our reports on investing in China.
- Searching for a supplier: either with or without a sourcing agent. You will need to visit the supplier's factory, send samples, do a test order, and so on.
- Sourcing fees: this depends on how the sourcing agent prefers to charge (commission, fixed one-off fee, or monthly management fee).
- Transport: handled by a professional freight forwarder, who will take care of all the procedures and costs involved (shipping, duties, handling, Document Destination Charges, labour fees, customs brokers fees, etc.).