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委外製造於中國之風險
Risks of Sourcing in China

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摘要

從中國採購和委外製造是在世界快速成長的現象，由於通訊和交通技術的發展，讓全世界各地的公司一起工作。在這種情況下，因為中國勞動力成本低、高科技製造能力高，加上政府在物流與基礎設施的激勵，中國成為許多公司領先的採購和委外製造的目的地。

然而，從中國採購使公司面臨很多的風險。過去的研究主要將研究問題集中於在中國採購時所面對的風險和不利的情形，探討如何減少風險以及成功的策略，主要由個案研究進行調查。而本研究主要集中討論採購和委外製造風險次數，藉由網路上數據的調查，利用統計的方式研究外國公司在中國採購和委外製造對於風險的看法，以及研究如何減輕其影響。

結果表明，最常見的風險問題跟中國合作夥伴之內部能力有關，如：品質問題、交貨期與文化的差異。中國公司內部能力涉及到風險之影響力也最高。因此，最重要的管理方式即為增強潛在的中國合作夥伴的選擇方法已發展雙方長遠關係，減少採購風險。

本研究作為一個基礎的中國委外之調查，其研究貢獻為指出產業中實際需應用之方式。最後，這本研究限制於受訪者之樣本，其研究結果或許難以一般化推論至其他公司。

關鍵字：採購和委外製造，風險管理，中國

Abstract

Sourcing is a fast-growing phenomenon in the world, due to developments in communications and transportation technologies, enabling companies from all over the world to work together. In this scenario, China is the leading destination for sourcing activities, mainly because of its low cost labor, high-technology manufacturing capacities, installed logistic infra-structure and government incentives.

However, companies that source from China face many risks. Past studies about sourcing in China focus mainly on listing its risks and unfavorable outcomes, debating best strategies to minimize risk or successful outsourcing methods, and mostly rely on case studies. This research focused on measuring the frequency of sourcing risks by the use of an online survey, and its importance to the foreign sourcing companies in China, and how they mitigate its impacts, providing a more complete analysis of the risks – which are not addressed in past studies.

The results show that the most frequent risks are related to the Chinese partners' internal capabilities: quality issues, delays on agreed delivery and receding quality; and cultural differences. The most impactful risks were also related to the internal capacities of the Chinese partners. Therefore it can be argued that the most important management tool for companies to reduce sourcing risk is to pre-evaluate thoroughly all its potential partners and enhance its selection method.

The study contributed to the literature as one of the few researches that are survey-based and indicated practical applications for real industries. The survey was limited by the low sample of respondents, which affects the generalization of the findings.

Keywords: sourcing, risk management, China

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Chapter 1. Introduction and Objectives

China is the fastest growing country in the world. In 2011, China surpassed Japan as the second biggest economy in the world (BBC, 2011), even if its economic indicators are worse than precedent years, as result of the changes in the global economic situation. In 2011, its “exports of goods and services constitute 39.7% of GDP. China major exports are: office machines & data processing equipment, telecommunications equipment, electrical machinery and apparel & clothing” (Trading Economics, 2012).

China has a central role in international globalized business and in the sourcing industry, because its “low cost of manpower, the rapid increase in the quality and quantity of its products, the availability of major logistic platforms” (Nassimbeni and Sartor, 2006) and high-technology manufacturing, becoming the leading destination for sourcing (Brown, 2005).

However, doing business with the Chinese proves to be a challenge to many foreign companies. “Managers of foreign companies are all trying to learn about how to be successful in China since they know that they must outperform in China in order to compete globally” (Quer, Claver& Rienda ,2010).

Previous literature has already presented the problems international companies face when dealing with Chinese enterprises and its products and services: Kam, Chen and Wilding (2011) lists “poor and inconsistent product quality, cumbersome and complex legislative requirements and trade regulation, convoluted contractual terms, difficulty in conducting quality inspection, late and unreliable deliveries and language, culture, and custom issues” as some of the few problems cited by previous research.

There are many past studies about sourcing to China and its risks – there are a great focus on listing risks and unfavorable outcomes, debating best strategies to minimize risk and

enumerate successful sourcing methods and practices, and usually they involved the use of case studies (Wang, Singh, Samson & Power, 2011). However, there are very few that focus on investigating the frequencies of said risks, and the impact to the foreign companies that sourced to China, so it is very difficult to analyze the results of sourcing activities and the impacts of complications of sourcing..

As risk is defined by two components – chance of occurrence and impact of said risk (Merna and Al-Thani, 2008), it is a worthy subject to study the frequency of bad outcomes. Also, the research can be valuable information for companies that want to try to source from China, by raising their awareness and understanding of the risks they may be facing.

Therefore, this paper aims to study the risks of sourcing to Mainland China (whether they are spare parts, knowledge, services or finished products) – which are the most common and important bad occurrences that happen when sourcing to China and how can companies minimize these risks. The method chosen was an online survey to assess the perception of individual from different countries and international companies about the subject. A clear study of the risks faced by companies that source to China cannot be complete unless both frequency and impact are included in the analysis.

The focus of the research will be on companies that source goods from China and its agents and intermediaries.

The online survey was sent in internet forums and social media communities that promote discussion about sourcing in China, as these sites are often frequented by individuals from different countries

1.1. Research Questions

1 – Which are the most frequent risks (bad outcomes) encountered by companies that sourcing from China?

2 – What are the most important and impactful risks that Western companies encounter when sourcing?

3 – What are the methods and management tools most frequently used to prevent and mitigate these risks (bad outcomes) from sourcing in China?

Chapter 2. Literature Review

2.1. Sourcing

Major advances in the information and communication technologies, as well as the easier access to material assets from low-wage countries and removal of trade barriers in the process of globalization have made it very advantageous for any company to look for new sources of competitive advantages in other countries (Christopher, Mena, Khan & Yurt, 2011; Lockström 2006). It has proven that global sourcing is not a popular phenomenon but in reality it has become a common practice to international companies. (Carter et al., 2008 in Rahman and Wu 2011).

There are many definitions for sourcing and its related terms “international purchasing”, “outsourcing” and “offshoring” (Karjalainen and Salmi, 2013). They are all related in some sort to the act of purchasing products or services from outside of the firm and often are used as synonyms.

Gilley and Rasheed (2000) described outsourcing as “procuring something that was either originally sourced internally (i.e. vertical disintegration) or could have been sourced internally notwithstanding the decision to go outside (i.e. make or buy)”. For Embleton and Wright (1998), “outsourcing refers to the concept of looking for expertise to handle certain business functions outside the existing firm. The decision-making process that management must undergo when considering outsourcing, hinges on a “make or buy” philosophy. More variables are brought into play when management considers outsourcing a product or service that is currently being produced internally. In today’s business environment it is now possible to outsource virtually any aspect of the business”.

In contrast, Monczka and Trent (1991) in Christopher et al, 2011, defined global sourcing as “... the integration and coordination of procurement requirements across

worldwide business units, looking at common items, processes, technologies and suppliers”. Sourcing can also be defined as the strategic selection of suppliers by a company, making them integral part of the buying company for the particular component or part or service that they supply (Zenz, 1994 in Zheng, 2000).

Offshoring relates to the acquirement of goods or products that were previously produced domestically from abroad either from fully owned subsidiary popularly referred to as “captive” or third-party vendor (Sharma and Loh, 2009).

Sourcing therefore is the general act of purchasing products, services and activities from the market (outside of the firm), while outsourcing is the procurement of goods that were once made internally by the firm, and offshoring relates to the geographical aspect of sourcing from foreign companies but from the same ownership. In this study, the term “sourcing” will be used in its broad meaning, which also include outsourcing.

The transaction cost theory (TCT) (Williamson, 2007; Walker and Weber, 1984) and the Resource Based View (RBV) (Barney, 1991) are two of the most used base knowledge to explain how companies should decide what activities to “buy” from the market, instead of doing it themselves. RBV states that companies should focus on their unique core resources - essential to the survival of the company in the long term, not easily imitated)- in order to survive, and getting from the market the other activities that are not their core. TCT argues that companies should “buy” activities when they are very costly (need investment in assets, very unpredictable results and circumstances) to be done by the company itself and are more efficiently done by the market.

There are many reasons companies source products and services, which include: enabling organizations to focus on core activities, costs reduction derived from cheaper labor, land, raw material and facilities (Beaumont and Sohal, 2004; Harland, Knight, Lamming & Walker, 2005; Monczka and Morgan, 2000.), obtaining access to skills (Beaumont and Sohal,

2004; Quinn, 1999 in Kam et al, 2011), obtaining flexibility (Narasimhan and Talluri, 2009 in Kam et al, 2011), and improving performance (Lonsdale and Cox, 2000).

There are also challenges and disadvantages to international sourcing. Due to many reasons, sourcing companies can encounter financial loss, instead of cutting costs, and loss of competitive edge. According to research by Beaumont and Sohal (2004), the three most important reasons for not outsourcing for Australian companies are: loss of control, dubious cost savings and loss of confidentiality. Another surprisingly finding for the researchers was that a common response as to why not outsource was “fear of a cultural mismatch”.

In conclusion, a company can purchase products (whether finished goods or raw materials), services and activities (logistics process such as transportation and warehousing, marketing, accounting, IT services, manufacturing) not only from companies of its nationality, but also from any place in the world, due to advances in communication and transportation, which enables the possibility to focus resources on core activities and which can lead to better performance. This is what came to be known as international sourcing.

2.2. Sourcing Strategies

Zheng (2000) presented an early view of sourcing strategies, with four categories:

1) multiple sourcing, in which a business relationship is set with many suppliers, bidding for the lowest price available and greater flexibility, however it is more difficult to establish long-term relations and long transaction costs (negotiation with and monitoring of many different firms);

2) single sourcing, in which the number of partners are limited, so the business relationship must be clear and effective, with exchanges between the entities, aiming at

setting a long-term alliance, as the company is at more risk position, so the selection and monitoring process is more strict;

3) An hybrid-network, in which it is established an network with different suppliers and the sourcing company, so the skills of all companies are shared and there are lines of communications between the different suppliers as well (usually present at assembly-type manufacturing industries);

4) and finally global sourcing, where the process of purchasing happen between companies of different companies, taking advantages of the different local characteristics (e.g. companies from more developed countries have access to companies with lower labor costs and regulations), but which requires extra efforts for coordination and communication, as there are many barriers (cultural differences, higher transportation and travelling costs, economic variables (exchange rate fluctuations), among others.

Kotabe and Zhao (2002) classified sourcing activities according to two criteria: direction of procurement and supply, and volume. Direction is related to the location of the sourced materials and the target market of the foreign company in China, reflecting its strategic objective, while volume refers to the magnitude of the sourcing activities, measured by percentages of procurement and supply. Thus, they presented five strategies for sourcing in China:

Market access (ST1): Components come from various sources for production/assembly in China for marketing there; Offshore sourcing (ST2): Sourcing components from various sources for production/assembly in China for marketing at home market; Offshore manufacturing (ST3): Basically, using China as a production/assembly location for components from home for marketing in other countries; Local sourcing (ST4): Sourcing components and manufacturing products in China for exporting abroad; and

Complex sourcing (ST5): Sourcing components from various places for production/assembly in China for marketing in various markets.

However, the present research was based on the views of Nassimbeni & Sartor (2006), which described that activities in China may “depend considerably on structural characteristics: the presence of governmental limitations in vendor selections, the presence and the kind of possible (inter)mediation forms (third parties), the content of the customer–supplier interactions, and the establishment of equity agreements between Western and Eastern parties.” They presented three types of sourcing, well documented by past researches:

A) “sourcing imposed” by the need to legitimate the presence of an enterprise in the Chinese territory (joint ventures, direct investments in China) so it is necessary for them to invest in some strategic industry in China, in order for the company to sell its product for the Chinese market. It may need to reallocate assets (know-how, capital, professionals, technology) to assist and monitor the production from the Chinese company;

B) “sourcing intermediated” by a third party at the purchaser–supplier interface – usually an international wholesaler who buys products on the Chinese market and resells them on other markets or an international service provider that sells its set of services to the foreign company (supplier selection, quality inspection, monitoring) based on their expertise when dealing with the Chinese;

C) and “direct sourcing”, in which neither intermediation or constraints connected with the choice of supplier are needed – it has different forms: with or without operational collaboration between the parties, with or without shareholding – the many foreign types of investment in China are included in this type, such as” wholly foreign owned enterprises, foreign invested companies limited by shareholdings and—since 2005—wholly foreign-owned foreign trading companies). “

Among the types of enterprise that can be established in China (joint ventures, wholly foreign owned enterprises, foreign invested companies limited by shareholdings and—since 2005—wholly foreign-owned foreign trading companies), the solutions that are usually adopted are the joint venture and the wholly-owned foreign enterprise (WFOE). In particular WFOE has recently become the prevalent choice of foreign investors. (Nassimbeni & Sartor ,2006; Clark and Wang, 2008)

The authors also note that these three types of sourcing may also coexist in the same company: for instance, a company can source directly for certain products and resort to intermediaries for others.

2.3. Sourcing Industry In China

Over the years, China has established itself one of the greatest and most dynamics economies in the world, mainly because of its industrial capabilities and low costs (Nassimbeni and Sartor, 2006), which are the results of investments made in the past, starting from the late 1970s, after the death of Mao Tse Tung, and turning it into a common destination for outsourcing (Fredriksson and Jonsson, 2009)

According to Nassimbeni & Sartor (2006), “since 1979, the Chinese government has launched a series of reforms that have gradually paved the way for economic growth”, which included incentives for foreign investments, creation of logistic infra structures, and investments in research and industrialization, meanwhile ignoring international complaints regarding the violation of property rights, in order not “hinder the first phase of industrialization”, and linking the exchange rate of their currency (RMB) to the dollar so ensuring a monetary stability, making it advantageous for other countries to import from

China and obtaining favorable conditions for entrance into the WTO (World Trade Organization) in 2001.

These investments have not stopped, as “over the last decade the Chinese government has continuously invested heavily in the construction of logistics and transportation infrastructure” (Rahman and Wu, 2011)

China became one of the most attractive place for outsourcing because of many factors: the low cost of manpower (Nassimbeni and Sartor, 2006; Brown, 2005, Lau and Zhang, 2006; Rahman & Wu, 2011; Perkowski, 2011); high manufacturing infrastructure and competence (Zakkour, 2012; Brown, 2005; Lau and Zhang (2006) ; Handfield and McCormack (2005) in Rahman & Wu, 2011); presence of its domestic market, that serve as incentive for foreign industries to outsource to China in order to serve the Chinese market (Nassimbeni and Sartor, 2006; Zakkour, 2012; Perkowski, 2011; Zheng, 2000) accessibility to other resources for productions, such as raw materials and commodities (Harris, 2012c; Zheng, 2000); and increase in the flexibility, quality and quantity of its products output (Anjoran, 2011; Nassimbeni and Sartor, 2006; Zakkour, 2012). The presence of governmental actions that support the manufacturing industry also is noted as a factor that stimulates outsourcing to China (Zheng, 2000; Nassimbeni and Sartor, 2006).

However, the Chinese economy also presents some weakness/liabilities for its sourcing industry as well: Rahman & Wu (2011) point out that the Chinese companies have difficulties in coping with fluctuating product demands, logistics competencies, and real-time distribution ability, as their concepts of supply chain management are “far behind those of their Western counterparts”, as well as problems related to its logistics infrastructure, difference in culture, human capital (unskilled and very mobile) and policies and regulations. According to Goh and Ling (2004) in Platts and Song (2010), China’s “ current logistics infrastructure, particularly those of transportation networks, telecommunications systems,

warehousing facilities and customs procedures are still relatively poor”. Another issue is the rising of prices and work wages in China, which erode its costs advantages and can cause some companies to outsourcing to other low cost countries, such as Vietnam and Malaysia (The Economist, 2011; Harris, 2012b).

Nevertheless, despite its shortcomings, China still presents itself as the best option for international sourcing, as its logistic infrastructure is still better than other low cost sourcing countries (Perkowski, 2011; Swizstick, 2008) – for example, one of the largest differences between the China and Vietnam is the level of port and logistics infrastructure – as well as Vietnam’s lack of access to resources and industrial technology, in comparison with China (The Economist, 2011; Perkowski, 2011).

In contrast, India is the leader of sourcing of services related to IT enabled Services (ITES) and Business Process Outsourcing (BPO). According to Oshri, Kotlarsky, Rottman and Willcocks (2009), India’s ‘role as the primary sourcing destination for these services was cemented in the late 1990s as multi-national corporations struggled to deal with the looming Y2K conversion effort. India was well positioned due to its educated work force, foreign investment friendly government policies, stable political climate and English language proficiency. India has steadily grown in its delivery capacity, higher value capabilities and reputation throughout the last twenty years’.

India’s information technology and outsourcing industries are expected to cross \$100 billion in 2012, a 14.8 percent increase from 2011 and double the value from 2007, while its share of global outsourcing industry was 58 percent in the 2011 fiscal year (Thirani, 2012).

2.4. Risks

Merna and Al-Thani (2008) define risk as a measure the probability of an occurrence of an event with negative connotations. Rowe (1977) defines as the potential for unwanted negative consequences to an event or activity (Merna and Al-Thani, 2008).

The authors also present that the difference between a risk and an uncertainty is in the possibility of measurement: “A decision is said to be the subject to risk when there is a range of possible outcomes and when known probabilities can be attached to the outcome.

Uncertainty exists when there is more than one possible outcome to a course of action but the probability of each outcome is not known”. Moore (1983) maintains that there are two basic components of risk. The first is risk as a future outcome, which can take a number of forms, such as a supplier raising prices. The second component is the probability that a particular outcome may occur..

- Khan and Burnes (2007) listed some authors that defined risk, stressing its negative risk:
- Lowrance (1980) describes risk as a measure of the probability and severity of adverse effects.
- Rowe (1980) defines risk as the potential for unwanted negative consequences to arise from an event or activity.
- Simon et al. (1997) perceive risk in terms of the likelihood of an uncertain event or set of circumstances occurring which would have an adverse effect on the achievement of a project’s objectives.

Because of its negative connotation, it is necessary to develop risk management tools to minimize its effects. There are many definitions and methods for risk management. For Dickson (1989) in Khan and Burnes (2007), it involves the identification, analysis and

response to risks which can threaten the assets or earning capacity of an enterprise. Cox and Townsend (1998), argue that “the actual process of risk management normally begins by assessing two factors: firstly, the likelihood of specific events occurring; and secondly, the consequences should the events actually occur”.

In the case of sourcing activities, the risk management process “may be summarily described as an exercise in value protection, the objective of which is to minimize the chance of delivery failures” (Kam et al, 2011).

2.5. Risks Of Sourcing

Some organizations do not achieve the expected benefits from global sourcing. For example, a survey made by Harland et al (2005) suggested that only five per cent of companies in their study achieved significant benefits from outsourcing.

The risks faced by international sourcing companies, or rather more specifically the negative outcomes derived from sourcing, are well researched and documented by past studies. The risk of international sourcing can increase due to extended material pipelines, longer lead times, reliance on new and unfamiliar sources of supply, total costs that may far exceed unit costs, and the management of cultural differences (Trent and Monczka, 2003).

Below is a condensed study of the most cited problems and challenges that arise from sourcing and particularly when western companies source from China:

- Extras costs that arose during production: Costs arising from implementing outsourcing operations - investment in additional infrastructures, delivery cost, etc. The extra cost generated may outweigh the outsourcing gains (e.g. Harland et al, 2005; Kam et al, 2011; Tsai, Liao & Han, 2008)

- Service provider's lack of needed capabilities - Services provider's capacity fails to meet buyer's product or service requirements (e.g. Dayton, 2011b; Ruamsook, Russell, and Thomchick, 2009)
- Fear of job Loss among staff - Staff dismissal or redeployment resulting from outsourcing, which weakens staff morale, loyalty and trust in organization.
(Harland et al, 2005; Lau and Zhang, 2006;)
- Use of confusing terms in contracts that lead to future problems and difficulties in delivery and quality (for instance, when the requirements of products sourced are not made clear and cause misinterpretation). (Harris, 2012a; Yount, 2013)
- Entering into a long-term contract with outsourcer could lessen an organization's flexibility because changes in business requirements or technology may render the contractual terms obsolete (e.g. Horn, Schiele and Werner, 2013; Kam et al, 2011; Tsai, Liao & Han, 2008)
- Information leakage - Leakage of confidential information due to openness and information exchange in outsourcing. (Christopher et al, 2011; Harris, 2011b;)
- Loss of control - Transferring control of certain processes or resources to service provider(s), which become hard and costly to reverse back when outsourcing ceases (Lau and Zhang, 2006; Tsai et al, 2008).
- Changes in market conditions make sourcing not beneficial (Kam et al, 2011)
- Social risks - Risk (e.g., communication failures) associated with social stability, and social, cultural language, and customs differences between organization and vendor/supplier. (Buckley, 2010;Wang et al 2011;)
- Chinese government laws and regulations that are hard to comply with (Hoenig, 2006; Wang et al 2011)

- Quality fade: loss of product quality over time (Enderwick, 2009a; Enderwick, 2009b);
- Fraud: the sourced supplier does not deliver or does not exist (Ajoran, 2012; Hoenig, 2006)
- Constant delays on the delivery time (Dodson, 2008; Ruamsook et al, 2009)

Some authors (Dayton. 2010; Harris, 2011a; Dodson, 2008) note that the specifically for China, sourcing companies will often encounter the risk of increased costs (due to hidden costs or opportunistic behavior by the Chinese), quality below expectations, contractual breaches, information and intellectual property theft, and physical risk due to poor working conditions. Rahman and Wu (2011) mention that “outsourcing to China faces further country specific constraints in terms of underdeveloped information technology, transportation, and telecommunication infrastructure, local protection regulations and lack of overall post outsourcing review “

2.6. Risk Management Of Sourcing Risk

Due to its negative impacts, companies should actively manage its operational risks. There are many reasons to managing risk, such as: reduction of possible taxes, reduction of transaction costs, and improvement investment decisions (Rawls III and Smithson, 1990 in Lam, 2003).

There are many strategies, methods and practices to mitigate and manage the risks of sourcing, with many past researches detailing its various forms:

- Internal enhancement prior to sourcing: Identifying core competencies before sourcing (Kam et al, 2011); Focus on core competence, product differentiation, proactive supply management (Khan and Burnes, 2007); creating a risk management culture within the company (Christopher et al, 2011).
- Supplier selection and management: Adopting multiple criteria to select service provider (Kam et al, 2011), creating systems to assess and monitor the supplier's performance, using multiple suppliers (Christopher et al, 2011; Khan and Burnes, 2007)
- Selective sourcing: Selectively managing a network of sourcing partners by allocating specific tasks to the most appropriate supplier based on their skills, limiting contract duration and measurement (Kam et al, 2011), ensuring suppliers quality, auditing standards, and proper certification (Dayton, 2010; Khan and Burnes, 2007)
- Contract management and Enterprise Risk Management: Managing contract to improve flexibility and trust, monitoring and evaluating adherence to the outsourcing contract (Kam et al, 2011). However, the Chinese people historically seldom use formal contracts to do business (Davidson and Ou, 2008) ;
- Verifying the performance of the sourcing companies: through quality assessment on the products and services provided (Davidson and Ou, 2008, Wang et al ,2011), as product quality has an effect on the transaction cost of sourcing (Fredriksson and Jonsson, 2009);
- Relationship management: Building long-term relationship, minimizing contract ambiguity, exclusive partnerships, establishing strategic alliances, risk sharing and knowledge transfer management – thus ensuring the collaboration between the parties(Christopher et al, 2011; Embleton and Wright, 1998; Khan and Burnes,

2007; Quer et al ,2010). In the Chinese case, the use and developing of the concept of Guanxi can also be included as relationship management (Kam et al, 2011; Ponte, 2007).

- IT infrastructure aid: Improving ICT infrastructure enables firms to obtain and increase supply chain visibility and improved communication, such as knowing inventory level or product flows (Kam et al , 2011;Khan and Burnes ,2007)

It is more effective to use many approaches when dealing with sourcing risks to achieve better results, instead of using a single method (Kam et al, 2011).

Power, Bonifazi and Desouza (2004) suggest that companies follow a disciplined outsourcing lifecycle methodology, in order to reduce outsourcing risks. They should prepare and analyze if sourcing and outsourcing are realistic goals and prepare accordingly (by protecting its intellectual property and other assets, and developing contracts carefully, and analyzing beforehand all possible rewards and risks, and prepare for when the relationship between the entities are to end, in order to avoid surprises.

Regarding the risk management practices that should be conducted when sourcing specifically to China, many authors emphasize the following practices as vital for success (Anjoran, 2012; Dayton 2010; Harris, 2011a, 2012a;Wang et al, 2011): thorough contract management, establishing quality standards and providing Intellectual property protection, noting that contracts should be written in Chinese language in order to be enforceable in China; monitoring of service and product quality, usually using a third party for inspections; and evaluating and certifying the potential suppliers, using various criteria beside price (e.g. possession of international certificates, physical visits to avoid fraud).

The results of the research by Fredriksson and Jonsson (2009) show that some industries in China (in their case, the casting manufacturing sector) are not reliable and

inconsistent, thus need to be continually monitored to ensure the quality level of its production..

The use of Guanxi is also noted by some authors as very important, when dealing with Chinese companies. The definitions of what is Guanxi differ slightly across the literature, but they all indicate that it is linked to relationship management: according to Quer et al (2010), “The Chinese word guanxi primarily relates to personal relations and involves the exchange of social obligations or favors (renqing) and the giving of social status or face in the society (mianzi)” and “it is widely recognised that guanxi is a key practically significant business determinant influencing firm performance because the lifeblood of the Chinese economy and business conduct is guanxi network.

It is related to the interpersonal relationships, connections and contacts, in which these can be used to provide mutual interests and benefits, “a medium for relational ties that bring business partners together through regular and voluntary reciprocal exchange of both favors and obligations” (Kam et al, 2011). The difference between Guanxi and the Western way of using its connections is that Western companies usually are guided by laws and regulations, with the use of binding contracts and are economically driven, whereas Guanxi are based on implicit and personal expectations, not limited to financial exchanges and based on social and moral laws and guidelines (Davidson & Ou, 2008).

However it is also perceived as a form of “culture of corruption” and detrimental to business, as some view it as a form to use connections to bypass laws, gain favors with Chinese government officials, and to hinder litigations from foreign companies (Brubaker, 2010). For Dayton (2011a), quality can be affected by Guanxi, as many factories will subcontract their own production to other companies, usually through the use of informal connections, thus getting better prices but with higher tolerance for quality deviation.

In sum, when sourcing from China, Guanxi must be also taken into account, as another tool for mitigating and controlling sourcing risks in china. Even today, the use of guanxi, relationships to facilitate business is very common among the Chinese (Ponte, 2007). Quer, et al (2010) propose that “there is a positive association between guanxi and performance in China”, while Kam, et al (2011) argue that “failure to account for the role of Guanxi on the choice of outsourcing risk management strategies would constitute an incomplete analysis”.

Chapter 3. Research Methodology

The aim of the research was twofold: 1.to gather which were the most frequent risks associated with sourcing in China and 2. To infer which risks had more impact to sourcing companies. An online survey was used to measure the frequency of risks, while in-depth interviews with professionals that source in China and the commentary received during the online survey were the methods used to analyze which were the most important risks of sourcing in China and the tools to manage and mitigate it.

3.1. Most frequent Risks: Online survey

The online survey method was chosen because the quality of the responses in online surveys can be the same as paper-based surveys (Gordon and McNew, 2008) and, with the advent of social networks, it is easier to reach many people from around the world than other methods, which in result made the scope of the research broader (Vasconcellos and Guedes, 2007; Wright, 2005). Other reasons include the availability of online lists of companies/communities and forums of the sample population of the study (individual from companies that outsource manufacturing activities to China), low cost, easy tabulation and formatting of the questionnaire.

The questionnaire was composed based on the literature review presented in the last chapter and was written using the software Google Docs. A copy is available at the appendix of this research. The questionnaire was separated in two parts:

1- The first part is designed to measure what is the frequency of each risk presented (total of 13 sourcing risks of China, taken from the literature and often quoted as frequent when doing business in China), in accordance to the perception of the survey participants. The use of five point Likert scale was chosen to measure the frequency, in which 1

represented “Never” (meaning the variable never occurred) and 5 represented “Very frequently”.

2- The second part was designed to measure the profile of the professionals that outsource to Mainland China, including their industry/area of occupation, type of outsourcing (based on Nassimbeni & Sartor ,2006), location of their outsourced company in China, their company’s country of origin, company’s size (by number of employees) and an email for contact.

The criteria to classify the size of the companies were taken from SEBRAE –BR (Serviço Brasileiro de Apoio às Micro e Pequenas Empresas) (2013):

Table 3.1
Criteria for company size
classification from SEBRAE

Classification	number of employees
Big	over 500 employees
Medium	from 100 to 499 employees
Small	from 20 to 99 employees
Micro	up to 19 employees

Using the results from the survey, the research presented the most frequent risks of sourcing in China, and made a few comparisons between the perception of companies of different industries, sizes, sourcing method and of Chinese partners of diverse locations.

The survey was mostly conducted in website “Linkedin”(www.linkedin.com), which is aimed at providing connections between professionals and it was believed to be best suited for this research, because would allow professionals in China to participate (Linkedin does not have its access blocked in China, whereas other social media such as Facebook are). Other methods of online survey were also attempted (sending the questionnaire to prospected

participants, publishing it in forums and websites about the subject) but were not as successful, as most of the replies were received from the online questionnaire was sent through the social network LinkedIn, through international communities of professionals that were associated with and participated in communities about in doing business with Chinese companies.

A topic of discussion was created in these communities urging its participants to answer the questionnaire about the frequency of the risks of sourcing in China. The questionnaire was also presented in 2 business online forums.

Table 3.2

Communities and website in which the survey was published

Linkedin Community

Analista de Comércio Exterior
 China Guanxi Network
 China Import & Export
 China Law Blog
 China Sourcing Forum
 China Trade Group
 Comércio Exterior BR
 Global Sourcing
 Import - Export / Global Trading Group
 Profissionais Brasileiros na China
 Sino-Brazilian Studies (SBS)
 Sourcing Forum
 The China Sourcing Information Center

Online forums

Global Risk Community
 Alibaba Buyer Forum

3.2. The most Important Risks Of Sourcing In China And The Management Tools To Mitigate it

The in-depth interview method for studying the most important risks was chosen because of the availability of the participants for interview and was a suitable approach to understand how the managers view and mitigate sourcing risk from China.

The in-depth in person interviews were conducted with 2 Brazilian managers that worked with sourcing in China, from different backgrounds and years of experience in China.

The reason for choosing Brazilian professionals was convenience and their willingness of the participants, as well as their experience in sourcing from China. The interviews were made in persona and conducted in Foshan, China, between 15/04/2013 until 25/04/2013.

The interview were semi-structured, which they were asked: “which are the most important risks that new companies that want to source in China need to be aware of?”, and discussion of which of the risks from sourcing in China are the most important, according to their opinion and experience. The risks presented were the same as the questionnaire about risk frequency.

The first person interviewed (A) was a business owner in the construction business, specialized in welding machinery and has sourced products and parts from China since 2006. His company is a retailer as well as a manufacturer of machines in Brasil.

The second interviewee (B) was a sourcing consulter that has worked in the construction sector but with focus on polycarbonate and aluminum plates for building facades. His company has sourced diverse products from China for seven years (as of 2013) and has planned to join a Chinese partner to start building a factory together in Brazil.

The results were then compared with commentary received during the survey on the frequency of the risks, in order to validate the opinions received and create a basis for comparison.

Chapter 4. Research Results

4.1. Risks of Sourcing In China

The research started responses in February 1st of 2013, when the first topic was created in LinkedIn, and finished in June 1st, 2013. Altogether, 36 professionals answered the questionnaire and 30 total comments were left in the LinkedIn communities, discussing the topics of risks of sourcing in China.

These participants were mostly from Brasil (19) and the USA (11), while 3 respondents were from China and 3 from other countries (France, United Kingdom and Canada).

In terms of demographic characteristics, 28 different industries were part of the research, including four from the automotive sector, two import agents, two from the furniture sector and two from the stationery sector. 24 companies classified their sourcing type as direct purchasing, and nine respondents indicated the use of intermediaries in their sourcing activity, while three informed that they had direct investment and partnership in China (WFOE / JV). Regarding the size of the companies in the survey, three were classified as Big (over 500 employees), 10 as of Medium size (from 100 to 499 employees), 13 as Micro business (up to 19 employees) and nine as Small (from 20 to 99 employees)..

Regarding the location of its sourcing partner in China, 11 locations were mentioned overall (most cited were Shanghai (9 mentions), Ningbo, Shenzhen, Shandong, Jiansu, Shanxi and Guangdong (2 mentions each)), while 11 respondents did not specify which places they source from (8 indicated various unspecified locations and 3 respondents left this in blank). 17 respondents replied that they only sourced from 1 specific location (Beijing, Ganzhou, Guangdong, Hebei, Hunan, Jiangsu, Jiujiang, Ningbo, Shanghai, Sichuan) and 15 mentioned various sourcing locations in China.

In the online survey, the respondents were asked to rank each of 13 different risks of sourcing in China on a five point Likert scale the frequency of the problem of sourcing from China in which 1 stood for “Never” and 5 for “Very frequently”. In the figure, the average mean frequency of each risk was calculated and ranked the risks from the most frequent (higher average) to the least frequent (lower average). Table 4.1. shows the statistical summary of the research findings.

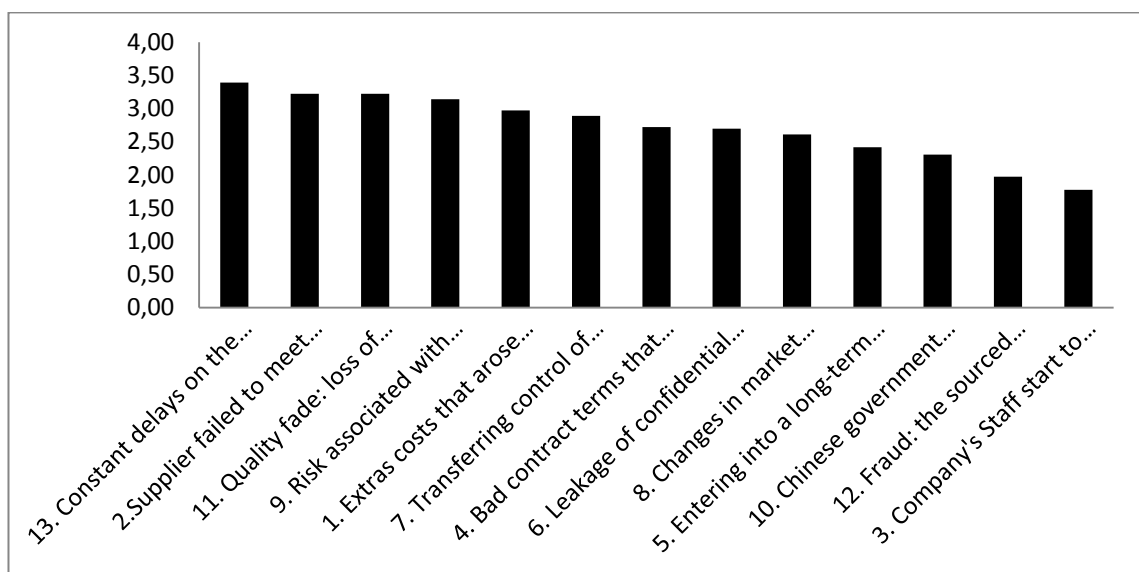


Figure 4.1. Mean frequency per sourcing risk, from most frequent (bigger average) to least, according to survey findings.

Analysing the data, the risks that were considered more frequent (average higher than three) were “13. Constant delays on the delivery time”; “2. Supplier failed to meet quality requirements/standards, due to lack of capabilities”; “11. Quality fade: loss of product quality over time”; and “9. Risk associated with social stability, and social, cultural language, and customs differences between organization and vendor/supplier”.

The least frequent (whose average was less than two) risks were “12. Fraud: the sourced supplier does not deliver or does not exist” and “3. Company's Staff start to be unmotivated or fearful of layoffs, because of outsourcing activities”.

All the other risks were considered to be of intermediary frequency (average between 2 and 3).

Table 4.1.

Descriptive statistics of the survey results per sourcing risk

	Mean	Std error	Mdn	Mode	Std. dev.	Mini	Max	Count
1. Extras costs that arose during production	2,972	0,162	3,000	3,000	0,971	1	5	36
2. Supplier failed to meet quality requirements/standards, due to lack of capabilities	3,222	0,204	3,000	2,000	1,222	1	5	36
3. Company's Staff start to be unmotivated or fearful of layoffs, because of outsourcing activities	1,778	0,150	2,000	1,000	0,898	1	4	36
4. Bad contract terms that led to future problems and difficulties	2,722	0,209	2,500	2,000	1,256	1	5	36
5. Entering into a long-term contract with suppliers that diminish the company's flexibility	2,417	0,201	2,000	1,000	1,204	1	5	36
6. Leakage of confidential information due to openness and information exchange	2,694	0,251	2,000	1,000	1,508	1	5	36
7. Transferring control of resources to supplier, which become hard to reverse back when relationship ceases	2,889	0,245	3,000	4,000	1,469	1	5	36
8. Changes in market conditions make sourcing not beneficial	2,611	0,196	3,000	3,000	1,178	1	5	36
9. Risk associated with social stability, and social, cultural language, and customs differences between organization and vendor/supplier	3,139	0,183	3,000	4,000	1,099	1	5	36
10. Chinese government laws and regulations that are to comply with	2,306	0,238	2,000	1,000	1,431	1	5	36
11. Quality fade: loss of product quality over time	3,222	0,174	3,000	4,000	1,045	1	5	36
12. Fraud: the sourced supplier does not deliver or does not exist	1,972	0,216	1,000	1,000	1,298	1	5	36
13. Constant delays on the delivery time	3,389	0,208	3,500	4,000	1,248	1	5	36

In the next sections, the results were used to compare the perception of risk of companies with different backgrounds, in order to achieve more insight on the subject.

4.1.1. Comparison of the risk frequency by different industries

The data was analyzed using the One-way Anova method, in order to compare the average means of different types of industries and to assess if there is any major important difference in the view of respondents from each industry.

Of the total 36 sample, 28 different industries were mentioned in the survey, which were then separated in 4 different groups for its analysis as the sample of the individual industries were too small. The different groups were classified based on the following assumptions:

- Agents ($n = 10$): import agents, or sub-contracting agent, or any other service providers and intermediaries related to sourcing.
- Distributors/ retailers ($n = 9$): who purchase finished products to be commercialized in their countries
- Manufacturers ($n = 14$): respondents that were sourcing for industrial parts and materials or its production output from China;
- Others ($n = 3$): other whose industries that could not be identified and classified accurately

Table 4.2
Number of respondents per
industry

Industry	Number of respondents
Agents	10
Distributors/ retailers	9
Manufacturers	14
Others	3

The results of the ANOVA test showed that only two types of risk presented barely significant difference depending on the type of industry: 8. Changes in market conditions make sourcing not beneficial (Sig = 0.104) and 12. Fraud: the sourced supplier does not deliver or does not exist (Sig = 0.002). The other risks did not present significant mean difference between different industries (Sig > 0.10).

Analyzing the post hoc Tukey test (shown in the table 4.3.) of the risks with significant difference and ignoring the risks without significant mean difference, for risk 8, the main difference was between the means of agents and distributors/retailers (Sig = 0.098), while for risk 12, the main differences were in the mean of by agents and the other types of industries.

It can be argued that, as agents act as an intermediary for other parties, they are more vulnerable to market changes, as they could lose their clients in both ways: Chinese sourcing company and the Western client company. Likewise, because of the nature of their operations, they must evaluate and consult with more Chinese companies to present to its Western clients, thus they could be more likely to encounter fraudulent companies and should be more likely to identify false companies, therefore, in their perception, they would be more prone to encounter these risks.

Table 4.3.

Post Hoc Tukey HSD Comparison of the risks with significant results between different industries

8. Changes in market conditions make sourcing not beneficial				
		Mean Difference	Std. Error	Sig.
Agent	distributor / retailer	1.200	.501	.098
	manufacturers	.254	.471	.949
	Others	.767	.737	.728
distributor / retailer	Agent	-1.200	.501	.098
	manufacturers	-.946	.471	.206
	Others	-.433	.737	.935
manufacturers	Agent	-.254	.471	.949
	distributor / retailer	.946	.471	.206
	Others	.513	.718	.891
Others	Agent	-.767	.737	.728
	distributor / retailer	.433	.737	.935
	manufacturers	-.513	.718	.891
12. Fraud: the sourced supplier does not deliver or does not exist				
		Mean Difference	Std. Error	Sig.
Agent	distributor / retailer	1.500*	.480	.019
	manufacturers	1.738*	.452	.003
	Others	2.200*	.707	.019
distributor / retailer	Agent	-1.500*	.480	.019
	manufacturers	.238	.452	.952
	Others	.700	.707	.756
manufacturers	Agent	-1.738*	.452	.003
	distributor / retailer	-.238	.452	.952
	Others	.462	.688	.907
Others	Agent	-2.200*	.707	.019
	distributor / retailer	-.700	.707	.756
	manufacturers	-.462	.688	.907

* $p < 0.05$

Note: not significant results were omitted.

4.1.2. Type of sourcing

The data was tested using the One-way Anova method, in order to compare the average means of different types of sourcing and identify any major important difference in the view of respondents from each type of sourcing methodology. The typology used to define the different types of sourcing came from Nassimbeni and Sartor (2006).

Table 4.4.

Number of respondents per sourcing type

Sourcing type	Number of respondents
Direct investment and partnership in China (WFOE / JV)	3
Direct purchasing	24
Use of intermediaries (trading/ consulting company)	9

The results of the ANOVA test showed that only two types of risks had significant difference between types of sourcing: 3. Company's Staff start to be unmotivated or fearful of layoffs, because of outsourcing activities (Sig = 0.028) and 6. Leakage of confidential information due to openness and information exchange (Sig =0.005). The other risks did not present significant difference between types of sourcing (Sig >0.10).

Table 4.5.

Post Hoc Tukey HSD Comparison of the types of the risks with significant results based on their sourcing type

3. Company's Staff start to be unmotivated or fearful of layoffs, because of outsourcing activities of the risks with significant results		Mean Difference	Std. Error	Sig.
Direct purchasing	Direct investment and partnership in China (WFOE / JV)	-1.417*	.508	.023
	Use of intermediaries (trading/ consulting company)	-.306	.324	.618
Direct investment and partnership in China (WFOE / JV)	Direct purchasing	1.417*	.508	.023
	Use of intermediaries (trading/ consulting company)	1.111	.553	.126
Use of intermediaries (trading/ consulting company)	Direct purchasing	.306	.324	.618
	Direct investment and partnership in China (WFOE / JV)	-1.111	.553	.126
6. Leakage of confidential information due to openness and information exchange				
		Mean Difference	Std. Error	Sig.
Direct purchasing	Direct investment and partnership in China (WFOE / JV)	-2.292*	.811	.021
	Use of intermediaries (trading/ consulting company)	.819	.518	.267
Direct investment and partnership in China (WFOE / JV)	Direct purchasing	2.292*	.811	.021
	Use of intermediaries (trading/ consulting company)	3.111*	.883	.004
Use of intermediaries (trading/ consulting company)	Direct purchasing	-.819	.518	.267
	Direct investment and partnership in China (WFOE / JV)	-3.111*	.883	.004

* $p < 0.05$

Analyzing post hoc Tukey test (shown in the table 4.5.) of the risks with significant difference and ignoring the risks without significant results, for risk 3, the main difference was between the companies that had direct investment and direct purchasing (Sig = 0.023). This is consistent with the logic that workers from companies that have direct investments in other countries should be more worried about their job situation, as this investment indicated that there is a possibility of the company outsourcing its activities overseas and cutting domestic operations, thus this problem would appear more frequently. Companies that only purchase directly would have less fearful workforce, as no investment could mean that intrinsic operations or activities are not being taken over to other countries.

For Risk 6, the difference was mainly from the results of direct investment. This result was consistent as companies with direct investment sourcing would have to share with more information about its operations methods and knowledge than other companies that only use intermediaries or do direct purchase thus have more chances of its confidential information being leaked. The use of intermediaries would lower the occurrence of this risk, according to the data.

4.1.3. Size of the company

The data was tested using the One-way Anova method, in order to compare the average means responses of companies of different sizes and its effect on the risk frequency.

The ANOVA test results showed the risks did not present significant difference between industries (Sig > 0.10), which is disappointing as it was expected some kind of difference in the results. This result can be attributed to the low sample.

Table 4.6.

Number of respondents per size

Size	Number of respondents
Big (over 500 employees) + Medium (from 100 to 499 employees)	14
Small (from 20 to 99 employees)	9
Micro (up to 19 employees)	13

4.1.4. Suppliers from Inner China vs. Suppliers from the Coast

Of the total 36 sample, the survey received 25 valid replies regarding the sourcing supplier location in China (4 blank, 7 responses did not specify the location). The results were then sorted by their position in China, if they were located in located at coast or were at Interior China, based on the provinces they were located on:

Table 4.7.

Number of respondents per sourcing partner (s) location in China

Location of the sourcing activity	Number of respondents
Located at the Coast (Shanghai, Shenzhen, Anhui, Jiangsu, Guangdong, Shandong, Zhejiang, Shaanxi, Ganzhou, Ningbo, Hebei)	20
Located at the Interior of China (Hunan, Sichuan, Jiujiang)	3
Both in Interior China and at the Coast (Zhejiang, Jiangsu, Hebei, Shanxi / Shanxi, Inner Mongolia, Hebei, Liaoning, Shandong)	2

This result is conformity and expected, as coastal areas receive more foreign direct investment, are more developed and more open to foreign companies, so more companies would find more partners there (Wei, Liu, Wang, & Wang, 2012). Because of the low amount of replies, it was advised not to run an ANOVA analysis and only a normal comparison of their average means:

Table 4.8.
Average mean frequency per sourcing risk & location

Risk	At the Coast	At the Interior	Both
1. Extras costs that arose during production	3.07	3.50	3.00
2. Supplier failed to meet quality requirements/standards, due to lack of capabilities	3.21	3.00	4.00
3. Company's Staff start to be unmotivated or fearful of layoffs, because of outsourcing activities	1.93	2.50	1.50
4. Bad contract terms that led to future problems and difficulties	2.14	5.00	2.50
5. Entering into a long-term contract with suppliers that diminish the company's flexibility	2.36	2.00	1.00
6. Leakage of confidential information due to openness and information exchange	2.64	5.00	2.50
7. Transferring control of resources to supplier, which become hard to reverse back when relationship ceases	2.71	4.50	1.50
8. Changes in market conditions make sourcing not beneficial	2.36	2.50	2.00
9. Risk associated with social stability, and social, cultural language, and customs differences between organization and vendor/supplier	2.93	4.50	3.00
10. Chinese government laws and regulations that are to comply with	2.21	1.50	3.00
11. Quality fade: loss of product quality over time	2.71	3.00	3.00
12. Fraud: the sourced supplier does not deliver or does not exist	2.29	1.00	1.00
13. Constant delays on the delivery time	3.29	4.00	4.00
Total Average Mean per Location	2.60	3.23	2.46

The results showed in table 4.8. that companies with Chinese sourcing partners located at the interior of China had a higher perception of risk (total average mean = 3.23),

which is consistent with the literature (Wei et al, 2012), that indicated that inland regions of china have less developed infrastructures and economy than coastal areas, thus can be concluded that companies sourcing there are more prone to encounter risks, though the sample is very small and not conclusive.

4.1.4. Multiple locations vs. single location.

Of the total 36 sample, the survey received 32 valid replies (4 blank) regarding the location of their sourcing activity, in which 15 respondents informed that they had sourcing activities from multiple location, while 17 respondents mentioned single locations (ranging from Shanghai(x6), Sichuan, Ningbo(x2), Hunan, Ganzhou, Guangdong, Jiansu, Jiujiang, Beijing, Zhejiang, Hebei).

Table 4.9.

Number of respondents per
number of sourcing locations
in China

Number of locations	Number of respondents
Single location	17
Multiple locations	15

The data was then tested using the One-way Anova method, in order to compare the average means difference of supplier location quantity, and identify any major difference in the risks based on the number of sourcing suppliers.

The results show that only two risks present real difference between companies that sourced from only 1 region from China and companies that sourced from different and multiple regions: 8. Changes in market conditions make sourcing not beneficial (Sig = 0.03) & 11. Quality fade: loss of product quality over time (Sig = 0.084). The other risks did not

present significant difference and between different variables (Sig > 0.10) and were omitted from table 4.10.

Table 4.10.
Summary of ANOVA per risk based on sourcing location
– only the significant results

8. Changes in market conditions make sourcing not beneficial					
	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	6.539	1	6.539	5.172	.030
Within Groups	37.929	30	1.264		
Total	44.469	31			
11. Quality fade: loss of product quality over time					
	Sum of Squares	df	Mean Square	F	Sig.
Between Groups	3.459	1	3.459	3.189	.084
Within Groups	32.541	30	1.085		
Total	36.000	31			

From the results shown in table 4.10., multiple sourcing locations present more chances of problems, and risks are more frequent, in regarding market conditions (e.g. more places where the economy could change or that the environment turns negatively) and the problem of the quality fade. However, overall there is no significant difference in the results of companies that source from only one location as compared to multiple locations, which is consistent with the findings from Blome and Henke (2009), that argue that there is no evidence that indicates with certainty that single sourcing or multiple sourcing creates higher risk.

4.2. The Most Important Risks of Sourcing from China

The interviews were conducted semi-structured, where it was asked the following questions to the respondents:

- Which are the most important problems of sourcing from China that companies need to be aware of, the ones that have more impact on the company?
- How does your company manage and minimize these risks?
- What is your view of sourcing in China?

Afterwards, they were asked to comment which are the most important risks based on the online questionnaire about risks frequency.

The first interviewed manager (A) was a CEO of a company in Brazil that has been sourcing from China for over 12 years, mainly directly purchasing of spare parts and finished products for the welding industry and machinery, and once with a trading agent. Its company has over 100 employees. Its suppliers come from many locations in China.

Overall, his opinion on present-day China's infrastructure is very positive; and comments that 10 years ago doing business in China was a lot more unsafe, probably 30% higher risk.

Here is a list of the main risks with sourcing in China:

- When using a trading company (an intermediary to broke its business), the costs are usually higher, as they can monopolize the prices and change suppliers without the knowledge of the sourcing company – which in result leads to poor quality and bad results;
- Lack of trust from the Chinese counterpart, demanding that payment should be made before delivery of its services/products (in contrast with the Brazilian culture, in which payment in many installments is the norm);

- Quality problems in the service/product – every project has its own particular problems, such as: different levels of quality for what was supposed to be the same product, poor quality packing, financial losses;
- One of the main problems is the way the Chinese communicate: usually, negotiations never seem to end, and Chinese people in general talk much but listen very little, and the different language is also a problem (related to the Risk associated with social stability, and social, cultural language, and customs differences between organization and vendor/supplier)
- Other important risks that the subject pointed out, after analyzing the questionnaire about risks: 2.the lack of technical capacity of the Chinese company, 6. leakage of confidential information (very easy to get information from the Chinese supplier about other competitor from Brazil); 11.Quality fade; 12. Risk of frauds

One great problem with sourcing in China mentioned was the pressure and relentlessness of the Chinese enterprise, in order to close deals and act almost as harassing the manager.

The second interviewed manager (B) was the purchasing agent of a Brazilian company that sources construction material and finished products from China, is a manufacturer and trader of aluminum plates for construction (PCP) with 250 employees, and has been dealing with Chinese partners for 10 years. Its sourcing partners are located in multiple locations in China.

Most important problems listed by the subject:

- Lack of quality in the services/products provided: this is very important and the potential importer needs to be very attentive to this aspect;
- Raising prices;

- Loss of benefits;
- Delays and extensions on delivery of goods;
- Frequency of the problems encountered;
- Other important problems mentioned, after analysis of the online questionnaire:

4. Bad contract terms that led to future problems and difficulties; 8. Changes in market conditions make sourcing not beneficial; 11. Quality fade: loss of product quality over time; 12. Fraud: the sourced supplier does not deliver or does not exist; 13. Constant delays on the delivery time – the last 3 are the most important risks that you need to be aware of.

All these problems could result in financial losses to the company in Brazil. In his words:

Brasil is a country with intense taxation [of its products and services]. If the quality of your product is bad, then you will lose your client, lose your brand, and paid double for a bad product. Also because the regulations in Brazil do not allow Chinese products to be returned to the exporter, so your company would be stuck with it.

He also mentioned that the following risks were not very important: 3. Company's Staff start to be unmotivated or fearful of layoffs, because of outsourcing activities is not very important in Brazil because alternative jobs are very easy to find; and 5. Entering into a long-term contract with suppliers that diminish the company's flexibility, as most of the contracts between the Brazilian company and its Chinese partners are not long term, and the company has many sourcing options and can choose and change depending on its own planning strategy and decision making.

4.3. Managing The Risks Of Sourcing From China

The following actions were mentioned during the interviews as the subject's methods to control and mitigate the problems of sourcing in China

- Constant supervision of the process
- Verify and investigate the Chinese source
- Only work with qualified partners
- Always get a sample from the sourcing company in China
- Evaluating the supplier before closing the business, assessing the quality of the production line – pre-selection and pre-evaluation is very important
- Do not use intermediaries – do it directly
- Educating and turning the Chinese company into partners, so that the factory will supervise its own quality

Other comments received online during the survey, in the online LinkedIn communities, stated that international sourcing risks could be diminished with due diligence prior to the process, realizing that it will be different from in-house production and that there will be almost certainly communication difficulties and cultural barriers. In their words:

The most common problem is my experience comes from the lack of initial due diligence and learning on the US companies part about the market conditions and cultural differences existing in the Chinese market. It is not possible to completely avoid sourcing issues in China, yet most issues I am asked to assist with stem from the sourcing entity being unprepared for the activity (typically by assuming it will be just like home) (Shawn Mahoney, 2013).

[Western companies looking to sourcing in China need to start] putting in the time and spending some money to learn as much about their potential business partner(s), China's business culture, and China's customs as they can if they hope to be successful.

They also need to get some good legal advice from someone who really knows how to do business in the PRC (Lex Smith, 2013).

Another commenter stated that in order to successfully source from China, companies need to establish and develop the relationship with its partner (Roorie Noonan, 2013):

Relations: you can't expect a Chinese supplier to provide you with outstanding goods at a ridiculous price! You need to create a win-win situation with the supplier, if you want it to last. Also if the supplier likes you, he will indeed be more reluctant to provide you with better prices. (Obviously quantity helps), if you try to cheat him, be sure that he will do the same to you, in one way or another.

Finally, another mentioned method to lower the risk of sourcing would be using of intermediaries that would overlook the operation and withhold payment in case the supplier does meet its requirement.

4.4. Risk Importance Vs. Risk Frequency – For Direct Purchasing Sourcing

In order to compare the results of frequency and importance, as to determine which are the most prone and important risks to be aware of when sourcing from China, only the information direct purchasing sourcing (in which companies buy directly products or components from the sourcing supplier) was used in the interpretation and analysis, as the findings about the importance of the risk were taken from the interviews, and the main type of sourcing performed by their companies was direct purchasing . So the results could only be applied only for this type of sourcing.

Based on the results of the interviews, the sourcing risks can be divided by its importance, as shown in table 4.11.

Table 4.11.

The More and Less Important sourcing risks of China, according to the interviews, in no particular order

More important risks	Less important risks
2. Supplier failed to meet quality requirements/standards, due to lack of capabilities	1. Extras costs that arose during production
4. Bad contract terms that led to future problems and difficulties	3. Company's Staff start to be unmotivated or fearful of layoffs, because of outsourcing activities
6. Leakage of confidential information due to openness and information exchange	5. Entering into a long-term contract with suppliers that diminish the company's flexibility
9. Risk associated with social stability, and social, cultural language, and customs differences between organization and vendor/supplier	7. Transferring control of resources to supplier, which become hard to reverse back when relationship ceases
8. Changes in market conditions make sourcing not beneficial	10. Chinese government laws and regulations that are to comply with
11. Quality fade: loss of product quality over time	
12. Fraud: the sourced supplier does not deliver or does not exist	
13. Constant delays on the delivery time	

In table 4.12., the average frequency of each risk was categorized and separated according to its likelihood (in which the risks with averages over 3 were considered of high frequency; while below 3 were considered low frequency) and its importance, as classified by the interviews.

Table 4.12.

Risk Frequency V.s. Risk Importance chart

Risks that are more frequent and very important	M	Risks that are more frequent and less important	M
13. Constant delays on the delivery time	3.46		
11. Quality fade: loss of product quality over time	3.38		
2. Supplier failed to meet quality requirements/standards, due to lack of capabilities	3.13		
9. Risk associated with social stability, and social, cultural language, and customs differences between organization and vendor/supplier	3.00		
Risks that are less frequent and very important	M	Risks that are less frequent and less important	M
8. Changes in market conditions make sourcing not beneficial	2.83	1. Extras costs that arose during production	2.83
4. Bad contract terms that led to future problems and difficulties	2.79	7. Transferring control of resources to supplier, which become hard to reverse back when relationship ceases	2.83
6. Leakage of confidential information due to openness and information exchange	2.71	5. Entering into a long-term contract with suppliers that diminish the company's flexibility	2.46
12. Fraud: the sourced supplier does not deliver or does not exist	1.96	10. Chinese government laws and regulations that are to comply with	2.29
		3. Company's Staff start to be unmotivated or fearful of layoffs, because of outsourcing activities	1.58

Note: the risks with averages over 3 were considered of high frequency; while below

3 were considered low frequency

Chapter 5. Results Discussion And Conclusion

China is the fastest growing country in the world, becoming known as the “world’s factory”, where anything can be made and produced in its territory, with a supporting supply system and capable workforce (Enderwick, 2009). Therefore, sourcing from China, whether as a source of components and finished goods or as a destination for offshoring and outsourcing, has become a viable economical option for companies that are looking to expand and enhance their performance. However, companies must be aware of the many risks from sourcing that are common among Chinese enterprises, which are well documented in the literature.

The aim of this research was to make a exploratory research and finding empirical data to indicate the most frequent risks of sourcing from China and the most impactful risks according to interviews with two managers from sourcing companies and online comments – there it would be feasible to separate the risks in accordance to their frequency and impact – which are the two elements that define risk (Fredriksson and Jonsson, 2009). The interviews also aimed at disclose the method used by the managers to mitigate and control the risks of sourcing in China.

5.1. The Most Frequent Risks

The results of the research indicate that the most frequent risks that occur from sourcing in China are related to the Chinese company’s internal capabilities and manufacturing skills and process – which include production line planning, equipment maintenance, warehousing. These are to be expected, as these risks are thoroughly discussed in the literature about sourcing in China.

Other frequent risks are related to the different language and cultural barriers from sourcing from international countries as well as loss of control of resources that are shared with the Chinese company (intellectual property, confidential information). The least frequent risks are related to the market conditions and Chinese regulation issues, as well as flexibility issues that occur when establishing long term contracts, the chance of being victim of fraud in China and domestic employees feeling unmotivated because of sourcing.

The factor analysis indicated that there two main types of risks in China, risks related to the internal capacity of the supplier and risks that are affected by the loss of control from the Western sourcing company, that could be resources or information, or even market environment conditions.

The findings also show that, using the method of survey described, organizations demographics have little relation to sourcing and the risk frequency perception. The most of the results were not significantly affected by the size of the companies, the type of sourcing, or the use of supplier from multiple or single location in China, the view of each segment only had significant difference in one to two different risks ($\text{Sig} > 0.01$). This suggests that the companies from different backgrounds have the same perception of the risks from China, or that the Chinese market treats all its sourcing partners uniformly, which is a surprising development.

The most significant differences occur when comparing companies' perception of risk based on the location of the supplier, from the interior of China or the coastal area. However due to small sample, the results are difficult to generalize.

5.2. The Most Important Risks

Comparing this to the results of the frequency survey, there is a consistency in the risks which are viewed as most important.

Although each of the interviewed professional had its own view on the use of intermediaries when sourcing, the most important and impactful risks that both mentioned are the ones associated with the internal capabilities of the sourcing factories as both mentioned the quality of products delivered as problem they are faced every time when sourcing from China, which is similar to conclusion drawn from the frequency survey. They also reveal that the most impact of the sourcing risk is financial losses and losing brand reputation , which would defeat the main purpose of sourcing from China: cutting costs (Wang et al,2011; Beaumont and Sohal, 2004)

Manager A also noted about the cultural differences, such as the matter of communication of the Chinese company and the matter of trust, as another major problem that needs to be addressed. In comparison, manager B did not mention any considerable problem about cultural differences and language issues. The possible explanation for this attitude maybe the business culture in Brazil: the Brazilian culture and custom of payment is very different than the Chinese. In Brazil, it is possible to pay customers and supplier in many installments, divided in many payments after delivery of goods or services, while the Chinese business custom is to pay everything upon delivery (Harris, 2011a/ 2011b).

These findings differ slightly from what is written in the literature, but also present some similarities. Wang et al (2011) argues that Government policies are the most important problem of sourcing from China in their research with Australian companies that source in China. Lau and Zhang (2006) noted that the major obstacles to sourcing in China, in the logistic sector, were lack of capable service providers, loss of control, poor infrastructure and local protection regulation. Rahman and Wu (2011) found in their research that the most difficult challenges when dealing with its customers for Chinese manufacturer was the cultural conflicts, which are also indicated by our interview, and constant contract changes.

5.3. How To Manage The Sourcing Risks Of China

The interviews with the manager and online comments made in communities about sourcing are in agreement that the main method to develop and manage the risks are the use of service providers to ensure the quality of products and supervise the Chinese partners, which is also suggested by the literature (Anjoran, 2012; Davidson and Ou, 2008; Dayton 2010; Harris, 2011a /2012b). Another key was to evaluate potential partners before starting any business relationship (supplier selection management) and developing a relationship with them, (developing Guanxi), as business in China are notoriously based on informal obligations (Davidson and Ou, 2008; Kam et al, 2011; Ponte, 2007). These findings are in compliance with the literature about sourcing risk management. The comments derived from the interviews and the online comments also had similar findings. The results also point out that there is not one fail-proof method of managing these risks and that companies sourcing in China should adopt many different approaches to mitigate its negative effects (Kam et al, 2011).

5.4. Risk Importance V.s. Risk Frequency – For Direct Purchasing Sourcing

The results showed which of the risks were the most important and most frequent for companies that perform the direct purchase type of sourcing. The higher risks are the risks that are related to the Chinese company's internal capabilities and supply chain, indicating that new companies looking to source from China need to be extra careful when selecting its Chinese partners, which is also confirm by the survey results and interviews.

The other risks were considered of less frequency, with its importance varying from each different variable, varying from risks associated with the market conditions, cultural

differences and supplier's capabilities. No risks were considered to be of high frequency but less importance.

Therefore companies willing to source from China should take extra attention to the risks in the first quadrant of table 4.12., and consider applying the management methods described in the research:

- Constant delays on the delivery time
- Quality fade: loss of product quality over time
- Supplier failed to meet quality requirements/standards, due to lack of capabilities
- Risk associated with social stability, and social, cultural language, and customs differences between organization and vendor/supplier

Delays on delivery, quality fade and supplier's lack of capabilities are risks that are highly dependent on the Chinese partner's capabilities. Thus the findings indicate that to manage these risks it is crucial to select the correct sourcing partners – the main factors to successful sourcing for sourcing companies can be attributed to detailed evaluation of potential supplying partners (Kam et al, 2011; Khan and Bumes, 2007), certifying and investigating of its capabilities and resources (Davidson and Ou, 2008), its track record with other clients , and also verification that the finished products and services are the same as required and in their contracts, through onsite inspections by the Western companies or hired third parties (Harris, 2011b; Dayton ,2011b). These methods and techniques would ensure that the qualifications of the supplier and its capacity and mitigate the sourcing risks.

Another approach, for companies that have already established relationships in China and are looking for more long term solutions would be to develop a close connection with its Chinese partners; that is to develop its *guanxi*. Through the development of its informal relationship, it is possible to avert or diminish the overall impactful negative outcomes of Chinese partners (Kam et al. 2011), as they would be more willing to give better prices, give

priority to your products (diminishing delays), and could be educated to take extra careful in the quality of the products, as they know that your relationship is of long-term and that quality will affect future orders, in comparison with other clients with less *guanxi*, which are less connected.

However, sourcing companies should not be deluded by the Guanxi – even with long standing relationships, there is always possibilities to arising problems, such as the case with global corporation Mattel (Enderwick, 2009a). There is no fail-proof method, and western companies should always have different and complementary strategies to mitigate sourcing risks.

Another frequent and important risk to take note is the risks associated with social stability and cultural barriers, which are harder to control: they come from culture differences, history and economical environment, thus are harder to predict and control. New companies can prepare themselves to these barriers and acknowledge that there will be problems stemming from this, by studying the Chinese culture and language before starting to negotiate with Chinese companies (Ponte, 2007), or hiring service providers (consultants and intermediaries) to facilitate the transition to international sourcing, as suggested by the interviews and online commentary.

5.5 Contribution

This study showed which are the most frequent risks that occur when sourcing in China, based on the valid data of 36 respondents of the online survey. The research indicates that the most frequent problems occur because of the lack of internal capacity and lack of planning by the Chinese company, which results in delays in the supply chain and problems with the quality of the results. Other frequent risks are related to the cultural barriers which

can include the customs and language and communication, between companies that come from different locations and the long distances. The most impactful and important risks of sourcing were also directly connected to the capacity of the sourcing Chinese company's ability and capacity of production.

The study suggests which are the most frequent and most impactful risks of sourcing in China. With these two information, risk impact and frequency, the research showed which are the most important risks that new companies looking to source from China need to be aware of, and classified the risks of sourcing in four major categories.

Another contribution to the literature is that there are not many researches about sourcing in China that are survey based, as most of it are based on case studies and use of macro-economic data (Wang et al, 2011). Thus this research provides quantitative data collected through a survey based study that allows empirical analysis.

There are also very little survey research using social media and online questionnaire, using new sources of research such as LinkedIn, in which professionals can gather and discuss issues regarding doing business in China.

Its results also can contribute to new companies that can look into the contemporary data and beware of the most frequent and important risks of sourcing in China thus can have knowledge to avoid and minimize them, as well as use the methods to manage it outlined in the research.

5.6. Limitation and Future Research

The research had some limitations in its analyses. One of them was the small sample size of the survey (36 respondents), compared to the population of the online sourcing communities, of frequency survey and the case of two companies about the importance and

impact of the risks. Therefore, it was not possible to use powerful statistical tools for its analysis and testing; it also affected the generalisability of our findings.

As this was an online survey posted in online forums and discussions, it was not possible to structure and filter who would reply to the research. The data was limited mostly by American and Brazilian managers/companies, as the research was conducted in English and in Portuguese, for conventionality reasons. Also, there was an unpredictable factor: most of the respondents were overwhelmingly from direct purchase sourcing companies (24 out of the 36 replies). Small companies were more predominant than medium and big sized companies. Therefore, different contexts and environmental settings may have generated different findings. Future research may focus on replicating online surveys in similar communities and expand the number of survey participants and consequently expand the types of companies of the respondents for the survey, giving a more robust case for quantitative analysis, in order to verify the generalibility of the study findings (Wright 2005).

Another limitation derived from the online survey format and its low response rate was that part of the original research about importance of risks was also survey based, but due to a lack of participants, it was changed to interview-based. However, the use of survey tool for the importance research would be better suited to gain empirical data, and future research may address this limitation.

Also, the inclusion of a third factor, the reason that these risks occur, could be incorporated, thus giving a more comprehensive and complete knowledge of the sourcing risks of China. For instance, Enderwick (2009) argues that suppliers often work on minute profit margins, which raises the incentive for opportunistic behaviour, particularly cost cutting, and it may result in lower expected quality levels (quality fade). Future research could address the co-relation between the cost cutting practices in Chinese sourcing companies and quality fade.

Other studies may also focus on the difference between sourcing in China and sourcing in other countries, such as Vietnam, Mexico and India, if the risk perception is similar between countries. In fact, one of the online comments received in LinkedIn during the survey argued that the risks and challenges in China should be same as other low-cost sourcing countries.

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APPENDIX

Online Survey Questionnaire: Risks of sourcing with Chinese suppliers

“How many times have you encountered the adversity described in the questions below, in your experience doing business in Mainland China. “ (The original questionnaire was hosted in Google Docs and was available in English and Portuguese)

Section 1 – Frequency of sourcing risks in China

Respondents were requested to rate the frequency of each different risk, according to their experience and opinion.

	Risk Frequency				
	1 - Never	2	3	4	5 - Very frequently
Risks of sourcing in China					
1. Extras costs that arose during production					
2. Supplier failed to meet quality requirements/standards, due to lack of capabilities					
3. Company's Staff start to be unmotivated or fearful of layoffs, because of outsourcing activities					
4. Bad contract terms that led to future problems and difficulties					
5. Entering into a long-term contract with suppliers that diminish the company's flexibility					
6. Leakage of confidential information due to openness and information exchange					
7. Transferring control of resources to supplier, which become hard to reverse back when relationship ceases					
8. Changes in market conditions make sourcing not beneficial					
9. Risk associated with social stability, and social, cultural language, and customs differences between organization and vendor/supplier					
10. Chinese government laws and regulations that are hard to comply with					
11. Quality fade: loss of product quality over time					
12. Fraud: the sourcing supplier does not deliver or does not exist					
13. Constant delays on the delivery time					

Section 2 – Background

Industry / Sector

Company's country of origin

Suppliers' location in China

Sourcing type in China (How do you source your products from China) – respondents were requested to select 1 of the following options:

1. Direct purchasing
2. Use of intermediaries (trading/ consulting company)
3. Direct investment and partnership in China (WFOE / JV)

Size of your company– respondents were requested to select 1 of the following options:

1. Micro (up to 19 employees)
2. Small (from 20 to 99 employees)
3. Medium (from 100 to 499 employees)
4. Big (over 500 employees)