SOURCING IN CHINA – (STILL) THE WORLD’S FACTORY

A NARRATIVE ON SOURCING TRENDS AND WHAT TO PURCHASE WHERE IN CHINA

December 2017
Business Sweden, China
AGENDA

- China – “The world’s factory”
  - What to source from where
  - China sourcing fundamentals and lessons learned
  - CSR and sourcing from China
  - How Business Sweden can support you on your sourcing journey
  - Appendix – The Sourcing check list
China is still the world’s largest exporter and considered “The world’s factory”

Comparison of top-10 exporters 2016

USD trillion

China’s export value is larger than several leading sourcing nations combined

China’s largest export sectors 2016

100% = USD 2,1 trillion

- China represents 13% of the world’s total exports
- Electronic equipment and Machinery are the largest export sectors
- Swedish import from China is USD 6,75 billion (5,6% of total import)
  - China is Sweden’s 7th largest import partner

China is unmatched when it to comes to sourcing, especially in electronics and machinery

Source: International Trade Centre, World Bank
When looking at the product categories within the fastest growing industries, more advanced products exhibit the fastest growth, e.g. engineering plastics for the building sector and food and medtech machinery.

Computers, although not among the fastest growing, includes cell phones which is China’s number one export (116 USD billion).

While export from China has grown significantly over the last decade, some industries exhibit faster growth doubling or more.

Plastics and furniture are still among the fastest growing, but significant growth can also be seen in more technologically advanced industries such as Machinery and High tech goods.

China is climbing the value chain in terms of production focus, no longer aiming at low-value production.

Source: ITC - International Trade Center
WITH THE 13TH 5-YEAR PLAN, CHINA AIMS TO BE ESTABLISHED IN EVEN MORE ADVANCED INDUSTRIES

“MADE IN CHINA 2025” A PLAN FOR TRANSFORMATION

- China aims to become the leading industrial power by 2049, where “Made in China 2025” is the 1st of 3 steps
- The focus is to move the economy away from labor-intense and low-value production towards higher value-added manufacturing
- Improve innovation by integrating technology and industry and enforcing green manufacturing
- “Made in China 2025” is an initiative to comprehensively upgrade the Chinese industry

CHINA’S LONG-TERM PLANNED ECONOMY

12th 5-year plan* 13th 5-year plan 14th 5-year plan

2011 2016 2021 2026 2049

THE GOVERNMENT’S FOCUS INDUSTRIES

Energy saving / New energy vehicles  Information Technology  Robotics and automation

Agricultural Machinery  Aerospace  Power Equipment  Railway Equipment  Ocean Engineering

New Materials  Medtech and Biotech

“MADE IN CHINA IN 2025” MEANS THE POSSIBILITY TO SOURCE MORE HIGH-END PRODUCTS FROM CHINA
WITH LARGE FOCUS ON ADVANCED MANUFACTURING
WAGES WILL CONTINUE TO RISE

GROSS SALARY DEVELOPMENT IN MANUFACTURING
CNY thousand per month

MINIMUM SALARY PER PROVINCE 2016*
CNY per month

- Wages within the Chinese manufacturing sector have increased rapidly over the last decades (8.4% CAGR since 2010)
- Wages are expected to continue to rise between 2016 and 2020 (6.4% annual average growth)
- Minimum salaries can differ significantly across China, ranging from 1,000-2,000 CNY per month
- Western and inland provinces generally have lower wages


*BASED UPON LATEST FIGURES AS OF AUGUST 2015, SALARIES PER PROVINCE BASED ON AVERAGE ACROSS UNDERLYING CITIES IN THE PROVINCE
RISING WAGES, INLAND SHIFT AND GOVERNMENT PROMOTIONS DRIVE THE DEVELOPMENT IN SOURCING

TRENDS

- Increasing wages
  - Fast growing economy and previous high inflation has been driving increase in wages
  - High demand for skilled labor such as engineers

- Shift in geographical region – Go west
  - Increased production costs combined with governmental incentives has lead to a search for new production areas
  - Exporters moving to Sichuan, Henan, Hubei and other inland provinces

- Governmental regulations and push
  - Investments in infrastructure for more efficient trading
  - China pushing for investments in more advanced manufacturing technology
  - Purposely moving labor intensive manufacturing activities to other countries

BACKGROUND

- China not necessarily the only or main source for cheap and low quality goods
- An increase in efficiency, quality and competence
- China developing as a global base for high tech manufacturing
- Potential to follow the movement inland in order to reduce production cost
- Inland provinces developing as national production hubs for certain product categories as metals, automotive parts etc.
- Developed infrastructure for international trade, e.g. through new silk road (see page 12)
- Better access to advanced and higher quality products
- To some extent less availability of cheap “low value added goods”

CHINA OFFERS INCREASINGLY HIGH AMOUNTS OF GOOD QUALITY GOODS AND HIGH TECH PRODUCTS

SOURCE: BUSINESS SWEDEN ANALYSIS
DESPITE SHIFT AND A RISE IN COSTS THERE ARE STILL NUMEROUS ADVANTAGES WITH SOURCING FROM CHINA

CHINA’S STRONGPOINTS AS A SOURCING NATION

- Cost efficient for higher volumes
- China developing as a global base for high tech manufacturing
- Rapidly growing economy
  - Investments in infrastructure and transportation systems
- Huge domestic market with rapid, sustainable growth
- Continuously increasing efficiency, quality and competence due to automation and advanced production
- Wider range of quality level
- Some products are unique for China – no other feasible sourcing destinations exist
- Increased IP protection for foreign companies (if trademark registered in China)
- Many export suppliers have long experience in collaborating with western businesses

DOWNSIDES OF SOURCING FROM CHINA

- China can no longer to be seen as the only and main source for cheap and low quality goods
- Distant destination, when in need of short delivery times Eastern Europe could be an alternative
- Country specific IP protection laws and trademark regulations
- Language barriers and cultural differences still significant
- Quality may differ significantly between suppliers
- Trade barriers in Europe on some categories of goods from China
- Chinese labor cost increase compared to other Asian countries could imply that some labor intense products are no longer cost competitive
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SOURCING IN CHINA, REGIONAL COMPARISON (1/2)
COASTAL REGION (MAIN SOURCING FOCUS FOR MOST WESTERN COMPANIES)

MAJOR PRODUCTION AREAS*

- **Jilin**
  - Pharmaceutical, steel

- **Liaoning**
  - Ceramics, magnesium

- **Shandong**
  - Textile machinery, clothing, textiles, axle bearings, transportation equipment

- **Jiangsu**
  - Electric wires, circuit boards, silk textiles, eyewear, ship building, silicone products, wood processing

- **Shanghai**
  - Electronics, textiles, machinery, financial services

- **Zhejiang**
  - Lighters, locks, electrical appliances, plastic products, textiles, shoes

- **Fujian**
  - Zippers, plumbing hardware, snacks,

- **Hebei**
  - Furniture, rubber, cashmere

- **Heilongjiang**
  - Linen products

- **Guangdong**
  - Machinery, electronics, packaging, lighting, automobiles, toys, shoes, denim clothing

*NON-EXHAUSIVE, BASED ON A SELECTION OF MAJOR CLUSTERS AND INDUSTRIES*
SOURCING IN CHINA, REGIONAL COMPARISON (2/2)
INLAND REGION

MAJOR PRODUCTION AREA’S*

**Xinjiang**
Cotton textiles

**Shanxi**
Chemical and machinery

**Shaanxi**
Machinery, fossil fuels, equipment for railways, mining

**Henan**
Aluminum products

**Sichuan**
Electronics, iron & steel manufacturing, textiles

**Hubei**
Plastics, automobile, medical products

**Hainan**
Agriculture, rubber, solar panels, herbal medicines

**Inner Mongolia**
Forestry, coal mining, food processing

**Chongqing**
Heavy transportation equipment and instrumentation

SOURCE: BEIJING AXIS, DEZAN SHIRA AND ASSOCIATES, CHAIN MEDIA, BUSINESS SWEDEN ANALYSIS

*NON-EXHAUSIVE, BASED ON A SELECTION OF MAJOR CLUSTERS AND INDUSTRIES*
TRANSPORT POSSIBILITIES BETWEEN CHINA AND EUROPE HAS IMPROVED, PARTICULARLY BY TRAIN

THE SILK ROAD ECONOMIC BELT (“THE SILK RAILROAD”)

- Transport possibilities is steadily improving between Europe and China and today there are possibilities to transfer goods by air, sea and train
- The One-Belt-One-Road (OBOR) initiative is an initiative started by China’s president Xi Jinping that focuses on connectivity and cooperation between Eurasian countries, included in OBOR is:
  1. The Silk railroad (see above)
  2. The Maritime silk road (connects China to Southeast Asia, Indonesia, India, the Arabian peninsula, Egypt and finally Europe by sea)
- Developing infrastructural ties with China’s neighboring countries is an effort to reduce both physical and regulatory barriers
- For companies transporting smaller volumes most logistic providers will offer shared container services for all transport mediums

SOURCE: FORBES, THE ECONOMIST, BUSINESS INSIDER
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FINDING AND MAINTAINING YOUR SOURCING NETWORK IN CHINA IS A CONTINUOUS PROCESS

COMPONENTS TO HAVE IN PLACE WHEN SOURCING FROM CHINA

1. PRODUCTION PLAN FOR CHINA
   Products, volumes, value, legal documents etc.

2. EVALUATION OF SUPPLIERS
   Identify a list of suppliers by evaluating their competence and your supplier criteria

3. INITIATING DIALOGUES WITH CHINESE PARTNERS
   Start initial discussions with potential suppliers by communicating your requirements and values

4. ON SITE DISCUSSIONS WITH PRODUCTION COMPANIES
   Check factory facilities, working conditions, agree on quality measurements, etc.

5. INTERNAL ROUTINES FOR SUPPLIER RELATIONSHIP
   When production is in place, establish routines to maintain regular contact with supplier

6. INTERNAL ROUTINES FOR INSPECTIONS IN CHINA
   Regular inspection of goods and factories to ensure CSR compliance.

7. CONTINUOUS DIALOGUE
   Follow up between companies and their suppliers e.g. updating of routines and agreements are essential for successful sourcing.
BE CRITICAL TO INFORMATION AND MIND CULTURAL DIFFERENCES WHEN SOURCING FROM CHINA

LESSONS LEARNED FROM HELPING SWEDISH COMPANIES IN SOURCING PROJECTS SINCE 1994

DIFFICULT TO FIND GOOD INFORMATION ABOUT A MANUFACTURER
- You will most likely not be able to find out the true information of a factory from a website
- To understand true performance and quality of a factory a visit is necessary
- You may not know if the production capacity will meet your requirements
- You will always get a ‘yes’, but there might be some hidden complications
- Hard to know if the factory will use a sub suppliers
- There may be fake quality certificates and credentials

ALSO DIFFERENCES BETWEEN SWEDISH AND CHINESE BUSINESS PRACTICES
- Continuous communication and reaffirmation is necessary (don’t worry to feel too pushy)
- Quality may vary from order to order – check and double check
- Misunderstandings could easily happen since the English level of the staff in the factory varies
- Your “big” Swedish order may not meet the minimum quantity requirement for production
- Unless you visit and investigate the factory, you won’t know if there is an agent or a actual manufacturer nor the conditions of the factory and handling of your products
- Have to be very specific about packaging and transportation
- Essential in China to have a good social relationship with your suppliers
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**CSR and sourcing from China**

- How Business Sweden can support you on your sourcing journey
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WHAT IS CSR AND WHY IT’S IMPORTANT FOR BUSINESS IN CHINA

"Corporate Social Responsibility is the continuing commitment to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large."

The WBCSD’s definition of CSR

<table>
<thead>
<tr>
<th>ENVIRONMENTAL</th>
<th>SOCIAL</th>
<th>ECONOMICAL</th>
<th>ETHICAL</th>
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</thead>
<tbody>
<tr>
<td>Environmental awareness</td>
<td>Diversity</td>
<td>Company strategy</td>
<td>Business values &amp; ethics</td>
</tr>
<tr>
<td>Sustainable use of resources</td>
<td>Employee satisfaction</td>
<td>Cost saving</td>
<td>Code of Conduct</td>
</tr>
<tr>
<td></td>
<td>Community involvement</td>
<td>Profit-making</td>
<td>Human Rights</td>
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<td></td>
<td>Charity</td>
<td>Sustainable development</td>
<td>Factory Monitoring</td>
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CSR is essential to businesses seeking to ensure long-term value creation, not only for branding but also for aligning with positive global impact on the environment and the people.
## CSR Work Can Be Driven on Different Levels

<table>
<thead>
<tr>
<th>Value</th>
<th>Purpose</th>
<th>Impact</th>
<th>Aspects to be Considered</th>
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<tbody>
<tr>
<td>Proactive and strategic engagement with CSR</td>
<td>Innovative and promotes sustainable business model</td>
<td>CSR is a key aspect of the company’s business</td>
<td>How can CSR engagement positively impact your company’s business strategy and results?</td>
</tr>
<tr>
<td>Respect of other universal principles</td>
<td>Compliance with global standards</td>
<td>A higher CSR profile</td>
<td>What are the potential CSR related risks faced by your company’s business activities?</td>
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<tr>
<td></td>
<td>Respect existing local law</td>
<td>Legal compliance is fundamental in order to develop CSR</td>
<td>Who are your company’s stakeholders?</td>
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<td>What are the impact of the cultural context and local traditions?</td>
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<td>What sort of legislation applies to your company and local business partner?</td>
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<td>What is the level of awareness of the local legislation of the potential partners?</td>
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It is important for your company to assess on what level you should drive your CSR work.
### ESSENTIAL AREAS THAT DEMANDS YOUR ATTENTION

<table>
<thead>
<tr>
<th>AREAS</th>
<th>SCOPE</th>
<th>EXAMPLE QUESTIONS FOR CHECKLIST</th>
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</table>
| Occupational safety        | Questions regarding the working environment, from training and equipment to safety and permission to breaks | ✓ Ask management: do you informed staff about procedure in case of a fire?  
✓ Ask employees: do you know what to do in case of a fire? |
| Labour conditions          | Questions regarding the circumstances for employment, from discrimination issues to payment and contracts | ✓ Ask management: What is the maximum amount of hours an employee can work per week?  
✓ Ask employees: What is the maximum amount of hours you can work per week? |
| Environmental protection   | Questions regarding the company’s impact on the environment          | ✓ Ask management: How does your company actively work to reduce environmental impact?                                                                                                                                                |
| Internal management        | Questions regarding the internal management of the company, from how they work against corruption to how they work to increase safety. | ✓ Ask management: How do you manage and control your suppliers to ensure that they follow CSR guidelines and code of conduct.                                                                                                      |
Business Sweden and the Swedish Embassy had developed an online CSR Toolkit available online.

We believe Swedish companies should be a global role model when it comes to sustainable development and CSR.

The toolkit is developed to support Swedish companies with their CSR work in China.

The toolkit can be complemented by training and seminars for your company regarding CSR work.

The full toolkit and more information can be found online at: https://www.business-sweden.se/Export/analys-och-rapporter/fact-packs-marknader-och-branscher/kina-att-hantera-csr-fragor-med-dina-leverantorer
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BUSINESS SWEDEN CAN SUPPORT IN ALL STEPS OF YOUR CHINA SOURCING JOURNEY

**BUSINESS SWEDEN SERVICES**

**SUPPORT OFFERED**

- Identifying, evaluating, selecting and meeting with potential suppliers
- Identifying potential sourcing clusters and relevant product categories to source
- Visiting program to pre-identified suppliers by your company with translation support and local knowledge
- Finding local QC companies to support your sourcing operations
- Financial assessment of suppliers
- Cultural workshop on doing business with Chinese suppliers
- Negotiation support
- Supplier check-up; having an employee from Business Sweden to contact or visit suppliers
- Sourcing fact pack; customized info based on your company needs
- Recruitment of skilled sourcing staff, financial services, etc..
- Your personal staff in our Business Support Office ready to execute on your strategy, e.g. to manage your sourcing operations, without establishing legal entity in China
- Support in establishing a company in China to support growth of your sourcing operations
- Help leverage China sourcing to sell and distribute in the region
- Align Sourcing strategy to optimize global purchasing
- Risk assessment and portfolio analysis
- Development of logistics setup
- Supplier crisis management
- Support with analyzing BOM** and identifying cost reduction opportunities

**BUSINESS SWEDEN’S SOURCING PORTFOLIO IS COMPREHENSIVE AND EXPANDS FURTHER BUSINESS DEVELOPMENT**

*ONLY EXAMPLES, SUPPORT FROM BUSINESS SWEDEN IS CUSTOMIZED BASED ON DIALOGUE WITH CLIENT ** BILL OF MATERIAL
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# CHECKLIST – QUESTIONS TO ASK YOURSELF WHEN CONSIDERING SOURCING FROM CHINA

**MUST HAVE QUESTIONS**

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
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<tbody>
<tr>
<td>What is the reason you are considering sourcing from China/Asia?</td>
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<td>What is your requirement on lead times?</td>
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<td>What are your expected volumes?</td>
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<td>How big part is this of your total purchasing spend?</td>
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<td>How vulnerable is your business to quality issues?</td>
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<td>How will this affect your brand?</td>
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<tr>
<td>Have you considered any potential trade restrictions and import barriers?</td>
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<tr>
<td>Do you plan to sell products manufactured in China for domestic market or other Asian countries?</td>
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<td>What are your requirements co-development of products with suppliers?</td>
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**GOOD TO HAVE QUESTIONS**

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
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<tbody>
<tr>
<td>Do you have internal staff and competence to manage communication with suppliers?</td>
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<tr>
<td>Do you have the competence to assess and work with your suppliers on CSR issues?</td>
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<td>Does your product have any unique IP protection that could be copied?</td>
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<tr>
<td>Have you considered currency exchange and payment terms? Do you have a strategy for this?</td>
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<tr>
<td>How easy it is for you to switch supplier? Are these stand alone products or ingoing components?</td>
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*ABOVE ARE ONLY SOME EXAMPLE QUESTIONS TO GET AN UNDERSTANDING OF THE NEEDS FROM THE COMPANY*
WHO WE ARE:
Business Sweden's purpose is to help companies in Sweden to grow their international revenues and international companies to invest and expand in Sweden.

We offer our customers strategic advice and hands-on support in 50 of the world's most interesting markets.

Business Sweden is owned by the Swedish Government and the industry, a partnership that provides access to contacts and networks at all levels. With international offices and a regional network of partners in Sweden, Business Sweden has the capacity to support you from initial business opportunity to final decision and establishment.