The Road to China
- The Alternative Establishment Chain of H&M, Fagerhult and Nordic Light

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Abstract
The purpose of this thesis is to study the establishment process of Swedish companies with sales in China, but who did not begun their establishment with sales. This thesis has examined H&M, Nordic Light and Fagerhult; three Swedish companies that recently started selling on the Chinese market, to see how their establishment chain differs from those suggested by the dominant internationalisation theories, Uppsala Internationalisation Model and the Export Behaviour Model. To study this alternative establishment chain, this thesis has interviewed representatives from each company. The results show that the firms have entered China primarily for sourcing reasons and then at a later stage set up a sales organisation thereby differing from the Uppsala Internationalisation Model’s Establishment Chain. This thesis’s establishment chain of the researched companies in China show that they have started with purchasing, then moved on to production for export, and then finally to sales.

Keywords: Internationalisation, Establishment Chain, Sourcing Strategies, Uppsala Internationalisation Model, China
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1. Introduction

China has been the destination for many companies and their international operations. Firstly they provide a market with much lower wages than what can be found in Western countries and secondly, the size of the market is huge. According to the consulting firm PriceWaterhouseCoopers, China has been the fastest growing major economy during the past 25 years and with a population of approximately 1.3 billion it is considered a consumer market with enormous potential for Western companies. Total consumer spending is predicted to reach $4.7 trillion by 2025 as a baseline scenario, with optimistic scenarios showing total spending reaching $7.3 trillion US dollars. (PricewaterhouseCoopers UK Economic Outlook Section IV July 2007) This makes China a very attractive market, not only for production, but also for sales.

A lot of research has been made on the internationalisation process of the firm where two of the most famous studies are the Uppsala Internationalisation Model and the Export Behavioural Model by Bilkey & Tesar (1977). These two theories focus on the companies’ internationalisation process as steps of establishment where the process starts with export and selling and then follows with further steps ending up with own production in the country. What has been the case for some Swedish companies are different, export and sales has not been the first step in their establishment. This indicates a new pattern that differs from the dominant theories of internationalisation and no previous research has been found on this type of establishment process. The initial establishment on the Chinese market can be explained by sourcing, which means that companies enter China for production-specific advantages that the market offer. Theories of sourcing by for example Davidson (1982) and Kotabe (1992) explain sourcing, as finding which production units will serve which particular markets and how the components needed for production will be supplied.
1.1 Purpose and Problem Definition

The purpose of this thesis is to study the establishment process of Swedish companies with sales in China, but who did not begun their establishment with sales. By studying the establishment process of H&M, Nordic Light and Fagerhult the thesis will try to answer the question; what steps did these Swedish companies take to enter the Chinese market and in what order?

As this thesis aims to research companies who did not start their establishment with sales, it goes against classical theories of internationalisation. Both Johansson & Wiedersheim-Paul (1975) Uppsala Internationalisation Model and Bilkey & Tesars (1977) Export Behaviour Model describes the internationalisation process in steps, starting with export. The researched companies in this thesis did not start with export, and the aim is to find what steps they have taken to establish themselves in China.

1.2 Disposition

Section 2 will outline the theoretical framework that this thesis will use. First the Uppsala Internationalisation model and Bilkey and Tesar’s export behaviour model will be presented. These models will represent the classical establishment steps theories and will be used to compare the researched companies’ establishment steps in China with the classical theories. The second theory used is on sourcing. This will represent the reasons behind why companies decide to establish themselves in China, i.e. for sourcing advantages. Section 3 will present how data for the research has been gathered, decisions made and what implications this has for the thesis. Section 4 will analyse and link the theories used with the empirical data gathered. The last sections 5, 6 and 7 will conclude and summarise the findings and will also present implication of this study and suggestions for further research.
2. Theory

As this thesis aims to study the process of internationalisation of firms trying to enter the Chinese market, it will use theories and models of internationalisation to provide a theoretical base for the conducted research. A lot of research has been done in the area of internationalisation, explaining how and why firms expand into foreign markets. For this thesis research done on the process of internationalisation and the steps taken by firms is of most interest and therefore, theories and models that focus on that aspect will be used. Chosen theories are Uppsala Internationalisation Model by Johanson & Wiedersheim-Paul (1975) and Bilkey & Tesar’s (1977) model. Theories of sourcing will also be presented; this will represent the reason behind firms entering China with production as the first step. Since no previous research have been found on firms having sales in China, but who did not start their establishment with sales, these three theories will represent our theoretical background that our researched firms will be compared to.

2.1 The Uppsala Internationalisation Model

The Uppsala Internationalisation Model is a model developed by Johansson & Vahlne (1977) and Johansson & Wiedersheim-Paul (1975) and focuses on the gradual increase in commitment to foreign markets and particularly on the successive establishment of operations in individual countries. The model was based on empirical data from the researchers’ studies, which showed that Swedish firms developed their international operations in incremental steps instead of making large-scale production investments. Johansson & Wiedersheim-Paul (1975) developed the Establishment Chain as a conclusion of their study of four Swedish engineering firms’ internationalisation, which is what will be focusing on in this thesis.

The model describes how firms gradually increase their activities in foreign markets. Although the Uppsala Internationalisation Model also includes the concepts of knowledge and learning as a base for the incremental steps taken by internationalising firms, focus will be on the Establishment Chain and how it holds up in today’s market. The model describes the internationalisation process as a series of steps, each taken when the firm learns and gains knowledge about the foreign market. The establishment chain looks like this:
The model describes the establishment chain as a series of steps towards increased commitment of the firm in the foreign country. Going from no regular export or only sporadic export, the firm begins to actively export goods through an independent representative or an agent in the country. The first real investment comes with the third stage, which involves setting up a dedicated sales subsidiary of the firm in the foreign country to handle sales directly. Often, this sales subsidiary is a previous agent. The last stage in the establishment chain is the establishment of the production unit, which Johanson & Vahlne, in their study, describes as often being set up to produce for local or regional markets.

The theory is not without criticism as researchers find that the theory is either outdated or lack taking other factors in to account. Nordström (1991) for example points out that the Uppsala Model does not take in to account external factors such as market opportunity or competition as considerations for the internationalisation process. Others like, Lindqvist (1991) mean that the model is outdated and that the model does not apply to high tech firms who cannot do incremental internationalisation due to high R&D costs. This forces the firm to internationalise faster and force technology-based firms to focus on internationalisation methods that let them maintain control of their knowledge. This is achieved by the firm through subsidiaries rather than agents. Another point of criticism is that the study, which is the basis of the model, is about large Swedish firms with vast resources and with similar international conditions, making the model only applicable on a very narrow selection of firms.

2.2 Bilkey & Tesar's Exporting Behaviour Model

Bilkey & Tesar (1977) have put forward a similar sequential model as the Uppsala Internationalisation Model. But where Johanson & Vahlne studied a few large firms in Sweden, Bilkey & Tesar studied the exporting behaviour of 423 small
manufacturing firms in Wisconsin, USA. They developed and tested a model which consisted of several stages explaining the export behaviour of small firms:

![Figure 2. Export behaviour model](image)

The study concluded that the exporting behaviour of firms does take on a stage-based approach, one similar to the above model, but not all of the stages were tested in the study. Their model, although not directly applicable to the problem definition of this thesis, can provide a background and material for comparison when trying to find a pattern of internationalisation among the firms in this study.
2.3 Sourcing

According to Davidson (1982), Kotabe (1992) sourcing is about finding which production units will serve which particular markets and how the components needed for production will be supplied. Due to global competition that many companies have faced the last decades it has been crucial for them to adapt a globalisation of corporate strategy. Advantages have been seen in creating and integrating various business operations across national boundaries. As a response to this, a lot of multinational companies have used sourcing of components and production on a global scale. (Kotabe 1990: 384)

As stated by Kotabe (1990), the reason for multinational firms to use sourcing of components and/or finished products is to keep its competitive advantage by looking outside their national boundaries. When developing sourcing strategies, not only manufacturing costs, cost for other resources and exchange rate fluctuations needs to be considered, also for example availability of infrastructure and industrial and cultural environment.

In Kotabe and Zhao (2002) study of sourcing in China they are proposing a broader approach to the understanding of sourcing strategy. In the study, direction of procurement and supply, and volume were used as decision rules to classify sourcing activities. Input, process, and output are generally what a manufacturing activity consist of. These components reflect only a small part of a MNCs global operation, but they reflect to a large extent the basic elements of the value-chain model developed by Porter. The reason for setting up a foreign operation is to produce a certain type of products, final or intermediary, using the inputs (sourcing) from different locations and supplying to various locations. The combination of procurement and supply of materials is the major part of sourcing and reflects the strategic objective that the operation abroad will serve. (Kotabe et.al. 2002:12-13)

According to Kotabe & Zhao (2002) there are five types of sourcing strategies:

1. Market access: This is a market driven sourcing strategy with the aim to penetrate and access the Chinese market through sourcing and selling in the local market. FDI operations are set up to act as a platform to serve the Chinese market. Most of the components and materials are sourced locally or from home and market most of the products in China. (Ibid: 13)
2. **Offshore sourcing:** This strategy sees China as a major production or assembly location with components sourced from various sources for marketing at the principal company’s home market. (Ibid: 14)

3. **Offshore manufacturing:** Components and material are supplied from home and finished products are marketed around the world. This strategy is internal sourcing. The two biggest reasons for this approach are first to take advantage of the low manufacturing costs. The second is related to quality control of components and to the protection of property assets embodied the components. (Ibid: 14)

4. **Local sourcing:** The strategy amounts to a wholesale transfer of engineering and manufacturing activities to China. This type of sourcing is often common in the end of the product life cycle were cost effectiveness is of most importance and the product and process technologies are well established. (Ibid: 14)

5. **Complex sourcing:** This strategy is globally oriented and characterised with multiple sources of components and materials from different locations and multiple sales to countries. This type of sourcing strategy serves as a global platform where no single source of supply dominates and sales of products are spread to multiple foreign markets. In China, operations are not necessarily established to access the local market, but to access the different advantages that exist there, i.e. low manufacturing costs. From where components and material are procured are dependent on the cost, quality, delivery time and so on.
3. Method

This chapter will explain the method, which the authors used to acquire and analyse the data for this thesis, and why the chosen method is best suited. It will present the companies researched and also what employee interviewed at each company. Further it will argue for the choices made and the implications it brings.

3.1 Selection

For this thesis, companies researched, entered the Chinese market following a different establishment chain than that presented by the Uppsala Model and the Exporting Behaviour model. The profile of the companies that this thesis wants to study is; those, which have sales in China, but that did not start their establishment process with sales. This means that examined companies that fit this thesis profile are the only ones included. Representatives who have experience of the companies’ Chinese expansion or are currently working in China are those who are interesting for this study. The companies and persons interviewed for this thesis are:

H&M

H&M is a Swedish clothing retail company with a long history of operations in China. The interview was held on May 4, 2009 with Björn Palmqvist between 10 and 11 am at his home. Mr. Palmqvist has worked at H&M from 1968. During the 1980’s he started to work with production. Between 1991 and 1998 he worked in Hong Kong as production manager for Asia. Mr. Palmqvist long experience within H&M and his seven years in China, working with production, makes him a good and valid interviewee. One downside is that he has never worked with sales. But because he has the necessary knowledge about the process and the steps that H&M took to go from production to sales, it does not affect the information this research intent to gather. The aim is not to gain deep knowledge about sales strategies, but to find the steps taken to go from production to sales, and this interview gave that information.

Fagerhult

The company is a Swedish lighting manufacturer that only recently ventured in to China. Fagerhult develops, manufactures and markets lightning systems for public spaces (www.fagerhultgroup.se, 2009-05-18). They operate in three main business
areas: professional lightning, store lightning and outdoors lightning, (www.fagerhultgroup.se, 2009-05-18). On May 15, 2009 an approximately 30 minute long telephone interview was held with Mats Johansson, CEO of Fagerhult Lighting Systems (Suzhou) Co. Ltd., China, a subsidiary of Fagerhult Group. Mr. Johansson has been involved in the whole establishment process, and being CEO of the operations in China makes him a good and valid interviewee.

Nordic Light
Nordic Light is another Swedish lighting manufacturer, specialised in energy efficient display lighting fixtures. The company designs, develops and market their products on an international market and has its headquarters in Skellefteå, Sweden (www.nordiclight.se, 2009-05-25). The interview for this study was held with Nordic Light’s CEO and Partner Bengt-Olov Lundgren. The interview was conducted on May 25, 2009 and lasted approximately 30 minutes. As CEO and Partner, Mr. Lundgren has been involved on the highest level with the company’s establishment and operations in China.

3.2 Sample Process
The sample process began by first requesting information from the Swedish Trade Council about companies established in China. The authors received access to a database with lists of subsidiaries of known Swedish firms operating in China. From there, the authors began looking up information on the firms. Once there was a list of companies with confirmed presence in China, the authors began contacting the firms to compare them against the required profile for this thesis. Appendix A presented at the end, show all companies contacted, either through e-mail, phone or both. Since this thesis wants to research a specific kind of companies that match the required profile, a lot of effort and time has been spent on contacting companies to see if they match the profile. As can be seen in Appendix A, most companies that have been contacted do not match the profile. These companies have either started their operations in China with sales or they have some kind of purchasing in China but have not started to sell there. The companies that are marked with a question mark are ones that have been contacted but where contact with the right person did not take place.
3.3 Acquiring Data

For this thesis, data have been acquired through in-depth interviews with persons of interest in Swedish firms with established production in China. These persons have or have had key responsibilities for the entry into the Chinese market. Data was acquired through phone and personal interviews. The purpose of the interviews was to research and gain information about the companies’ process of entering the Chinese market. With this information an analysis of the companies’ process of entering the market has been made to see what steps they have taken, in what order and in what way this is different from what the classical establishment steps theories of internationalisation suggests. The reason for choosing interviews is the complexity of the subject and that the information that this thesis aim to acquire cannot be quantified in a meaningful way, when information about the reason behind certain decisions are of interest. An interview is also creating a more open atmosphere for discussion. There is also a better chance for follow up questions.

The reason for choosing telephone interviews is that the respondents have been someone with a high position in his/her company and therefore busy and a telephone interview is quicker and easier to conduct, also one of the interview subjects was located in China. A weakness with this type of interviews is that it can only go on for a limited period of time since it is hard to keep the respondents interest up if the subject does not interest him or her, it is also harder for the respondent to get a idea of how long the interview will go on (Lekvall & Wahlbin 2001: 266). This can be helped by throughout the interview inform the respondent about the time remaining. Another down side with telephone interview is that the interviewer cannot see facial expressions or body language.

When conduction a qualitative research with in-depth interviews there is always a risk that the person interviewed does not give a correct picture of the reality. There is a risk that the person wants to give a better picture of the company than reality or that he or she answers the questions in a way they think the interviewers want. This risk has to be weight against the benefits of an in-depth interview and take in to consideration throughout the interviews and the thesis.

After reviewing our choices of qualitative and quantitative research method, the decision fell on qualitative method. The authors believe that a qualitative method is the best way for understanding which steps and in what order firms take to enter the
Chinese market. The reasons behind this different approach to internationalisation is what is intended to be explored and interviews provides a better way to capture more information than a quantitative method would. A qualitative method allows the authors to gain a deeper understanding of the subject. A risk with choosing a qualitative method is the low number of respondents. This can make it hard for the authors to generalise the findings to a broader population, in this case Swedish companies entering the Chinese market. This because the findings cannot be measured with a statistical data analysis, more focus will be on the authors in the analysis section of the thesis.

Semi-structured interviews has been used, asking the respondents to tell the stories of their Chinese establishing process in their own words before directing the interview to more specific questions as to the process and the reasoning behind the decisions the companies’ took when entering China.

### 3.4 Research Limitations

The main obstacle for this thesis is the limited numbers of companies that have been interviewed. With only three companies researched it will be hard to generalise any findings in this thesis. It is not possible to say that this thesis is representative for Swedish companies entering China or that the findings can be generalised. Instead, this research should be seen as indicative of a different establishment chain that can be observed in Swedish companies entering China.

This thesis will only handle the establishment chain and examine the reason behind the entry into China. This implies that other aspects in especially the Uppsala Internationalisation Model will be left out of this thesis. Further, the aspects of success regarding sales or of the establishments will not be presented. The purpose of this thesis is to investigate how the researched companies have established themselves, not if the establishment has been successful or not.
4. Swedish Companies’ Establishment Process in China

This section will outline the research done on the Swedish companies H&M, Fagerhult and Nordic Light. The information presented here is all based on the interviews held with employees at the three companies.

4.1 H&M

This section of the thesis is based on the interview with Björn Palmqvist from H&M held May 14, 2009.

During the 1950’s, 60’s and 70’s a lot of European textile production came from Hong Kong. During the late 1970’s economic zones was established in China for foreign companies to operate in, especially in southern China. During the 1980’s with beginning in 1981 H&M started to really look into the possibility to have production in China. By then, the first production office was already established in Hong Kong in the late 1970’s. The reason for setting up the first production office was to get hold of textile quotas that was in place, to have control over production in China and to start building up an organisation in China for H&M. From the start H&M was purchasing through agents and the goal of establishing in China was to cut these middle hands and buy directly from the factories and the suppliers. From 1981 H&M had three employees in Hong Kong travelling around in China, mostly to Shanghai, to make business, buying textile from different cooperation’s without H&M having any registered company. It was in 1994 that H&M registered their first formal office. Offices were established in Shanghai, which is the biggest office, and Beijing and Canton City who works mainly as smaller service offices. During that time China had gone through great changes, but still the consuming pattern was not interested for H&M so the reason for the establishment was purely for production. From operating one production office in 1981 H&M today has 4 production offices with around 400 – 500 employees working only with production in China.

From the middle of the 1990’s the consumer pattern started to change, but still H&M had no intention to open stores in China at that time, they just wanted to produce more in China. The reason why H&M decided to establish in China was not only because of low production costs. China has through history been a big producer of textile. When H&M went in to China there were already factories producing cloth,
weaving mills and also a broad workforce who were skilled producers of textile cloth. Therefore, cheap production costs combined with the knowledge in textile made China a natural choice for H&M when it came to production, according to Mr. Palmqvist. H&M have never had their own production facilities and in China there was a great supply of production facilities, another reason why they entered China.

It was in the beginning of the 21st century that China became attractive for H&M for sales. Mr. Palmqvist thinks that it was around 2003/2004 that the board started to consider the possibility of opening stores there. H&M is a growth company with a goal of annual growth of around 10% to 15%. This meant that H&M needed to find new markets for setting up stores because they were established in most countries in Europe and USA before the first store in China opened. Because of changing consumer pattern in China and also because of increasing consumer purchasing power, the potential market in China had grown to a level that made the market attractive for H&M. Most important, at that time the potential market had grown to a level so it would be profitable for H&M to penetrate the market through sales. China has a huge population, but the increase in purchasing power among consumer was what had changed the consumer pattern and created a market for H&M. As Mr. Palmqvist pointed out, in a city like Shanghai with 15 million inhabitants, if 10% of them had the possibility to buy H&M cloth, it is a huge market for H&M, and that was only one city in a huge country.

There was no clear connection between H&M having production offices in China and the opening of stores there; they just wanted to penetrate the market because they saw it profitable for the company. In 2007 H&M opened their first store in Shanghai and today they have 13 stores in China. In the end of 2009, Mr. Palmqvist assumes there will be around 20 stores in China. Each market has an office responsible for the market, and in China the head quarter is in Hong Kong, responsible for Hong Kong and China. The first organisation around sales got in place a few years before the first store opened in 2007. The main organisation for sales was established around 2006 to make sure that the opening of the first store and the continued expansion would be successful. The sales organisations job is to serve the stores with for example marketing and human resources. As of today, most of H&M’s employees in China are working with production, but as more stores will open this will probably change to sales in the future.
4.2 Fagerhult

This section is based on the telephone interview with Mr. Mats Johansson, CEO of Fagerhult in China, held on May 15, 2009.

The company has a relatively short history in China compared to H&M and Nordic Light, having only begun purchasing in the country in the early 2000’s and establishing its first manufacturing plant in 2005, with manufacturing taking off in 2006. Fagerhult’s purchasing was done straight from Sweden without the use of an office in China, having the responsible purchasing personnel travel between Sweden and China when necessary. The company’s goal was to first set up manufacturing to take advantage of sourcing strategies; exporting the products to their other markets to quickly get a positive cash flow for the Chinese operations. This enabled the company to then use the money to slowly build a sales organisation. The production company in China is a wholly owned subsidiary of Fagerhult although the plant premises are leased.

Mats Johansson said that this strategy ensured that the company had enough money for a penetration of the Chinese market without having to receive more funding from the HQ in Sweden. If they had gone in with sales first, the company would have risked a lot of time spent in China before witness a positive cash flow. The company set up its first representation office in Suzhou in 2005. Fagerhult chose to instead enter China as a sourcing strategy, exporting the production back to Sweden before starting to build a sales and marketing organisation to target the Chinese market. Mr. Johansson said that by setting up production first and exporting to their other markets the Chinese operations were able to quickly get a positive cash flow, money that could then be used to establish their Chinese sales organisation. According to him, it would have taken much longer to get a positive cash flow if they had set up their sales organisation first.

Fagerhult got its first major contract in China in 2007, following minor contracts in 2006, shortly after the company had entered the country and set up its production plant. Today, approximately 15% of the production in China is sold there. In the future, Mats Johansson hopes that it is reasonable to estimate that at least 40% of the production will remain in the country for the Chinese market, while the rest are exported to other markets.
4.3 Nordic Light

This section is based on the telephone interview with Mr. Bengt-Olov Lundgren, CEO and partner of Nordic Light held on May 25, 2009.

Nordic Light has a relatively long history in China, having first entered the country in 1992 with the opening of a production office in 1992. The office had the responsibility to handle the contacts with Chinese suppliers regarding production. According to Mr. Lundgren, the country could produce the required components at a lower price and the infrastructure was in place to make purchasing cost effective. Mr. Lundgren also said that they decided on China because at the time, the risk of inflation was comparatively lower than other countries. When they first entered in 1992, the thought of sales in China was in the company, but no plans for it. In 1999 the company took the decision to set up its own factory in the country, moving away from only purchasing components and products from suppliers. The reasoning behind the decision was the desire to consolidate all of the company’s production to China and distribute the products from there. Once the decision was taken, the company’s factory was established in 2002 in Suzhou and sales to Chinese clients started shortly thereafter.

Of the company’s production in China, approximately 3% is sold on the Chinese market. The rest is distributed to Nordic Light’s other markets through the company’s subsidiary in Hong Kong. Nordic Light sees about 5-10 million SEK in sales per year in China. An interesting observation that Mr. Lundgren made is that over time, it has become relatively cheaper and not more expensive to have operations in China. According to him, having access to their employment and salary files, they used to see twenty-three Chinese employees on one Swedish salary when they first entered China. Today, that number hasn’t decreased but increased to about thirty Chinese employees on one Swedish salary. Mr. Lundgren attributes this to the fact that Swedish salaries have increase much faster than the Chinese, making China a reliable sourcing destination for the foreseeable future.
5 Analysis

Section five will combine and discuss the empirical data based on the interviews with H&M, Nordic Light and Fagerhult with the theoretical framework that this thesis uses. The goal is to analyse the reason behind the establishment, the establishment process and the steps that these three companies have taken in China.

5.1 The Reason for Entering China

Through the interviews with H&M, Nordic Light and Fagerhult it is clear that these companies establishment in China was part of a sourcing strategy. In the case of H&M, the low production costs and also the local knowledge in textile production was part of the reason for entering China. The first production office that was set up in the late 1970’s in Hong Kong was a part of the strategy to have production in China. The reason for establish in China was a clear sourcing strategy, they wanted to buy cheaply produced cloths, due to low production costs, for exporting back to countries in Europe were they had sales at that time. The commitment in China grew from the initial start during the 80’s and the 90’s, but the reason for establishing in China remained purely for production. Fagerhult established in China in the early 2000’s with purchasing and later set up a wholly owned production plant and as stated by Mr. Johansson, the reason for entering China was to set up production to take advantage of sourcing strategy and to sell what was produced on other markets in the beginning. With lower production costs in China they could quicker generate a positive cash flow for the Chinese operations, used to build up a sales organisation. Nordic Light entered China in 1992 by establishing a production office, having responsibility to purchase products in the country without having any own production there. They increased their commitment by opening their own factory in 2002, having decided to put all their production in China. The big difference between H&M, Nordic Light and Fagerhult’s reason for entering China was that H&M had no intention to sell on the Chinese market, something that Fagerhult and Nordic Light both had, even though Nordic Light chose to wait longer than Fagerhult to enter the market. All three established in China to get hold of lower production costs but the intention to sell there is what differs between them.

As stated by Kotabe (1990) the reason for companies to source is to keep its competitive advantage. When applying this to the three interviewed companies they
saw it necessary for their competitive advantage to produce cheaper products. One difference between the three companies production is that H&M still produce their products external because they buy their cloth from different suppliers, while Fagerhult and Nordic Light now produce their products internally in their own factories, having started with purchasing. A reason for this can be the higher complexity of their products with a higher degree of technology in both the products and the production that make it desirable for both Fagerhult and Nordic Light to have production internal.

There are five types of sourcing strategies according to Kotabe & Zhao (2002). When applying them to H&M, Fagerhult and Nordic Light it is possible to see a difference. For Fagerhult, their reasons for the Chinese operation are similar to market access. They set up production in China in order to faster penetrate the market through sales. Even though what initially was produced was exported back, the Chinese operations could have acted as a platform to help their establishment in China. Nordic Light went in primarily for sourcing reasons, finding the production costs to be considerably lower in China. Because of H&M’s long history in China, it is possible that their sourcing strategy has changed over time. In the beginning H&M's strategy could have been offshore sourcing because the company was smaller than it is today and they did not have sales in that many countries. But over time it has changed to a strategy more similar to complex sourcing, where the Chinese operations act as a global platform, and no single source of supply dominates and products are spread to multiple foreign markets. Nordic Light’s strategy seems similar to H&M. Their first entrance on the market was for purchasing, but after the decision to set up their own production to serve both China and other markets they fit the strategy of complex sourcing. They saw China as a platform for production from where production and distribution would take place, sales is not the primary goal, the production advantages that China offers are. It is possible that Fagerhult’s sourcing strategy in China will develop over time, but that is something that only time will tell.

5.2 The First Step

According to the Uppsala Internationalisation Model (Johanson & Wiedersheim-Paul 1975), a firm begins its establishment process by exporting to the target foreign market and ending with production. The three companies interviewed, went against the establishment chain presented in the Uppsala Model. A long period of time
separates H&M, Nordic Light and Fagerhult’s entry in to China but all three companies began their establishment through purchasing. None of the companies exported to China, thereby circumventing the Exporting Behaviour Model.

H&M entered China in the late 1970’s when employees from the recently established Hong Kong office began travelling around China, mainly to Shanghai, to initiate contact with suppliers. During that time, China was much different from the consumer powerhouse it is today, and H&M had no plans at that time to enter the Chinese market with sales; there was simply no market for them to enter. From the start H&M was purchasing in China through agents and the goal of the establishment was to cut the prices by purchasing directly from the suppliers. Fagerhult took its first step some twenty years later in 2000 when it began purchasing in China. For Fagerhult, there was a market to enter. China’s economy had boomed in the past years, but Fagerhult still chose to set up production in the country first and benefit from this sourcing strategy before setting up their sales organisation in the country. According to Fagerhult, the company wanted to build up a positive cash flow for the Chinese operations as quickly as possible and starting with sales would have taken them longer time to achieve this goal. By instead setting up production and benefitting from the sales to existing markets, they were able to finance the sales organisation being set up in China. Nordic Light first steps in China began with purchasing when a production office was set up in 1992 with the task of buying products from suppliers. For H&M the reasons were different as when they first entered China, there was no consumer market for them to enter. It was only in the last decade that the company saw the opportunities in the Chinese market arise, when the middleclass in China began to grow. Nordic Light had the intention to also sell on the Chinese market in the future when the first office was established in 1992, but they did not know when they would start.

H&M, Nordic Light and Fagerhult all began their establishment with purchasing. H&M and Nordic Light were handling it through production offices while Fagerhult chose to handle the purchasing from Sweden, having employees travelling to China for purchasing. The difference between them is that H&M has no ownership in any of its suppliers in China, managing them instead through their production offices. Fagerhult and Nordic Light on the other hand invested in their own production plants. All three companies have also completely circumvented the Export Behaviour Model presented by not exporting to China to begin with. By
making the first step in their establishment chain with purchasing instead of export, the companies stray away from the establishment chain presented by the Uppsala Internationalisation model. This is mainly because sales were not the primary or only drive for these companies, but rather the benefits of sourcing strategies. This is especially the case for H&M and Nordic Light because most of what is produced in China is sold on other markets. Fagerhult had more intention to sell when they entered but chose to begin with purchasing. Today they sell approximately 15% of what is produced in China, but the goal is to increase this in the future to around 40%. Their focus was more on sales in comparison to H&M and Nordic Light.

### 5.3 The Establishment Chain

Through the interviews and research in H&M, Nordic Light and Fagerhult’s entrance in to China, a different process for entering China than the Uppsala Internationalisation Model and its establishment chain presents. There is both a different order in the chain as well as a difference in the actual steps taken. The Uppsala Model’s chain breaks down the establishment process in to these steps:

![Figure 3. The Uppsala model establishment chain](image)

The steps taken by the companies in this thesis are different:

![Figure 4. Alternative establishment chain](image)

The companies researched and interviewed began their establishment chain with having no purchasing, then purchasing and then by setting up production, either by building their own production plants as Fagerhult and Nordic Light did or by setting up a supplier network managed through production offices, which is the way H&M chose to do, since they do not own any factories. All three companies then began to export the products produced in China to other markets. H&M’s products went to
markets where they had retail stores and Nordic Light and Fagerhult’s products went mainly to Sweden and their other markets. Lastly, they started sales in China.

Going from one step to another takes more or less time, depending on factors such as the maturity of the market and the aggressiveness of the establishment, whereas Johansson & Wiedersheim-Paul’s (1975) establishment chain attributes the move from one step to another to the firm having gained more knowledge about the market. In H&M, Nordic Light and Fagerhult’s cases, they started to export their Chinese-manufactured products to other markets immediately after entering the country but it took much longer before H&M was ready to set up a sales organisation in China than it took for Fagerhult or Nordic Light. The reason for this is market maturity.

When H&M began producing in China in the late 1970’s, early 1980’s, neither the consumer market nor the Chinese economy matched H&M demands of a strong and growing middle class that had the money to buy their products. H&M had to wait approximately twenty-five years before opening its first store in China. Even though H&M has no own production plants, they took more control over the production when they established their production offices in China 1994. This can be regarded as the Production and export step in the model that is presented in Figure 4. By establishing the production offices, they had a better ability to manage their suppliers and the production of H&M products in China. The reason behind the need for increased control can be the increased strategic importance of the production in China, the possibility to minimise the risk of child labour in factories producing for H&M and cut the middle hands to lower costs. Still H&M had no intention to sell on the Chinese market.

Nordic Light and Fagerhult on the other hand entered China when the market was more mature for their products, especially Fagerhult. Nordic Light had been established in China for purchasing reasons since 1992 before making the decision to set up production there in 1999. In 2002, ten years after the first establishment the production was running and shortly after, they started to sell. This strategy is similar to H&M, but their next step after purchasing was to set up their own production plant in order to lower production costs and have control over the production process due the higher degree of product complexity compared to H&M’s products. Fagerhult followed a similar path as Nordic Light by first having purchasing in China before they set up their production plant in 2005 and had minor contracts as early as 2006
with major contracts awarded in 2007, only 1-2 years after setting up production. Fagerhult saw from the start that there was potential in the Chinese market and they had decided to engage in sales directly after setting up production in the country. This made their move from purchasing, to production, to sales, relatively quick. Nordic Light had entered the country earlier, having set up their production in 2002 but having had a presence in the country since 1992. Nordic Light chose a slower approach to the Chinese market, waiting until 2002 to set up production and then begin selling to the Chinese market. For Nordic Light, there was a mix of market maturity and market opportunity that led the company to sales in China; having had plans for sales from the start but having to wait for the market to mature before that step could be taken. H&M on the other hand had a very long period of time separating their move from purchasing to sales, having had to wait for the average consumer market to grow and the market opportunity to arise. Especially in the case of Fagerhult the establishment process has been fast compared with what is described in the Uppsala Model. It is impossible to say if H&M’s move from production to sales would have been faster if the market had been mature for their range of products when they first established there over twenty-five years ago. Although the three companies had long periods of time between their first steps in to China, all three companies began selling to the Chinese market within five years of each other. This can be explained by the market at that time being mature for all three companies’ range of products and the company seeing the market opportunity first in recent years.

For all three companies the majority of the production is still exported to markets outside China. For Fagerhult, only approximately 15% of the production remains in China while the rest is exported. Nordic Light, which consider China mainly as a source for production saw just 3% of its production remain in China for sale. For H&M, where the first store opened in 2007, a very small part of the production remains in China. This is both because of the stores having opened recently but also because H&M in China also imports products produced in other countries such as India and Turkey. Fagerhult set up their sales office very quickly, the same year as their production company, having a very aggressive and quick entrance in to the Chinese market. H&M on the other hand did not even consider opening stores for the first twenty years, waiting until other firms entered the market and then following when they saw the time right for it.
The types of companies researched and the difference in what drives the companies’ international process can explain the differences between the establishment chain that has been observed and the one presented in the Uppsala Model. The companies researched in the Uppsala Model were all large Swedish industrial firms with vast resources and long history. Those companies expanded internationally because of their drive to expand and increase profitability; each market entered would increase the companies’ sales and profit. In comparison, the companies researched are relatively modern companies and their main drive for entering China was not sales, at least not immediately. Instead they wanted to benefit from the sourcing strategies to be able to compete globally by lowering costs. Selling in China became the secondary focus and in some ways remains the secondary focus. Fagerhult for example expects that the percentage of production that will remain in China for sales will at most only reach about 40 % from today’s 15 %, the rest reaching other markets. Nordic Light sells only 3 % of its production in China to the Chinese market and due to the heavy focus on production; they do not expect that number to increase dramatically. The case with H&M is a bit different, because of their annual growth goal of 10 – 15 %, they see China as a market with great potential for reaching that, but this was not the case when they first entered China but is something that has developed over time. H&M expects the Chinese market to be a growth market for them, but also noted that the country could probably provide both sales and purchasing for the company for the foreseeable future due to the country’s size and economical diversity. Fagerhult and Nordic Light also foresee that although sales will grow, the majority of the production will still be exported to markets outside China.

No empirical information on if gaining of market knowledge is what made the three companies to go from one step to another in the establishment chain has been gathered, but there is reason to believe it has affected the companies. The steps that the companies have taken differ in time between them. Fagerhult has been quickest in its establishment, taking only 6 years from purchasing to sales. It took H&M over 25 years to make the same journey, and Nordic Light more than ten years. A big reason behind H&M and Nordic Lights longer time between the steps is market maturity. Fagerhult first established in China when the market was more developed and there was a potential for sales. As stated by Mr. Palqvist, H&M engaging in sales had nothing to do with the fact that they were already represented in China for production, but that the consumer market was ready for H&M to penetrate. If the same is true for
Nordic Light, it means that the knowledge they gained through having purchasing and production in China was the knowledge of when the market was ready for them to enter. This could imply that the incremental steps and gaining of knowledge about the foreign market, that the Uppsala Model advocates, does not apply to our researched companies.

It should also be noted that there is another difference between the Uppsala Model establishment chain and the one presented in this thesis. In the Uppsala Model, the production step refers to production set up to serve mainly that particular foreign market, whereas in this thesis’s establishment chain, the production is set up to primarily serve other foreign markets.

The timeline illustrated below gives a clear overview of the establishment of H&M, Fagerhult and Nordic Light, pinpointing some of their key establishment chain steps. This also gives an overview of the time span between the first step in to purchasing and sales and shows the companies establishment process in China relative to each other.
5.4 Implications of the Study

As mentioned above, a problem with this study is the fact that only three companies have been examined. Of twenty-seven companies that have been contacted, five of them fitted the profile, one did not want to participate and the authors have not been able to interview a representative from IKEA. Because of the low number of participants in the study it is hard to make any generalisations or say that this thesis is representative. But what this study has done is to open a door for further research on the subject. It has shown that there are Swedish companies that go against the classical establishment steps theories, suggesting that companies enter the Chinese market for production and then moves on to also sell on the market, which means that the study is indicative rather than representative. If more companies had been researched the findings would have been stronger. Through our sample process we have found that there are several companies that now have purchasing in China but that has not yet started to sell there. If they decide to sell in China in the future, they will follow the same establishment chain that has been presented in this thesis (Figure 4). This is something that future research will have to conclude.

The three companies interviewed goes against both the Uppsala Internationalisation Model and the Export Behaviour Model. All went in to China for purchasing due to sourcing strategies; the difference between them is that Fagerhult had the intention to sell from the start, while H&M did not and Nordic Light had it in mind for the future but no immediate plans. One explanation for this is the time frame; H&M was first established in China more than twenty years before Fagerhult and although Nordic Light entered later than H&M, their focus was from the beginning also on the sourcing benefits rather than the sales potential. But they have followed the same pattern, starting with purchasing and then moving on to sales. While Fagerhult and Nordic Light have their own factories, H&M started their establishment process with setting up production offices and when the market was right, started to sell. Nordic Light, Fagerhult and H&M have followed the steps presented in this thesis model.

One implication is that companies going in to emerging markets might follow the steps shown in this thesis. This could offer a better understanding of the internationalisation process of firms entering markets with sourcing strategies, but conducting a research covering more firms entering the Chinese market or another
emerging market for sourcing reasons can only conclude this. In the case of Fagerhult the sourcing strategy to enter China is an internationalisation strategy itself. By entering the Chinese market through production they were able to build up a positive cash flow by exporting back what was produced before engaging in sales. The case of H&M is different because they were present in China a long time before they started to sell there. But being present on the Chinese market made them aware of the changing trends in consumer behaviour that made them see China as a possible market for sales. Because of their sourcing strategy they were able to enter the consumer market at a time that was right for the company. The same pattern can be seen for Nordic Light, they were present in China for ten years through a production office handling purchase before setting up their own factory and moved on to also sell their products in China.

With further studies it may also be possible to generalise the findings to a certain type of companies. Where the Uppsala Internationalisation Model is able to generalize old, classic Swedish firms, the alternative establishment chain could be applicable to relatively young Swedish firms with products that can be produced cheaply in foreign countries for a global market, much like H&M, Fagerhult and Nordic Light’s.
6. Conclusion

This thesis has examined Swedish firms with sales in China but which had initially entered the country not having sales or export as the first step. The three examined firms are: the clothing retail company H&M, the professional lighting manufacturer Fagerhult and the display lighting manufacturer Nordic Light. The conclusion of this thesis is that a very different establishment chain arises when studying companies that recently entered the Chinese market. Where the Uppsala Model’s establishment chain shows the establishment process as a process that begins with export and ends in production, the results of this study indicates that some companies may instead follow a different establishment chain that takes them from purchasing to sales, if the firm is primarily searching for sourcing benefits. A reason for this can be that the reasons behind export for increasing sales and sourcing strategies are different. For the three companies examined, entering China was part of their sourcing strategies finding cheaper ways to produce their products. This means that sourcing strategies can be an internationalisation strategy itself for entering emerging markets. This is clear for Fagerhult and Nordic Light who saw setting up purchasing and later on production, as a way of entering the market to have a platform from where they could build up a sales organisation, although Fagerhult had a more determined approach than Nordic Light. Due to the longer time H&M has been established in China, it is hard to make the same conclusion. When they first entered the market it was not interesting from a sales perspective. But as the consumer market grew stronger and bigger during the 90’s and 00’s they went from only having production in China to also build an organisation for sales with the first store opening in 2007, more than twenty-five years after the first establishment.
7. Suggestions for Further Research

The result of this study show that there is room for further research in the internationalisation process of firms, studies that take in to account different reasons for internationalisation such as sourcing instead of sales. Further research, with a larger selection of companies studied, could also increase the understanding of the internationalisation behaviour and what steps companies take in their internationalisation process. Using a larger selection of firms in these studies would also allow for the results to be representative and perhaps allow for alternative internationalisation models to emerge, covering a wider variety of firms than those that the Uppsala Internationalisation Model represents.

Another interesting research would be to look at other emerging markets to examine if there are companies following the same pattern as the companies in this thesis have followed in China. This could show that firms entering emerging markets follow a different establishment process than firms entering industrialised countries.

Further studies could show if the results may also be applicable on companies of similar type as H&M, Fagerhult and Nordic Light; relatively young companies compared to those studied in the Uppsala Internationalisation Model. Companies such as Biltema, Lindex and Clas Ohlsson also fit this type. These companies, also having purchasing in China but no sales yet, could be taking their first steps towards a Chinese market penetration even if it is not the case at this time.
8. Bibliography

Primary Data

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Lundgren Bengt-Olov, telephone interview, 2009-05-25

Palmqvist, Björn. H&M, personal interview, 2009-05-04

Books


Research Articles


**Electronic Sources**


### Appendix A – Contacted Companies

<table>
<thead>
<tr>
<th>Company</th>
<th>Matched our profile</th>
<th>Interviewed?</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABB</td>
<td>No</td>
<td>Yes, it was during the interview that we found that they did not fit our profile.</td>
</tr>
<tr>
<td>Assa Abloy</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Atlas Copco CMT Sweden AB</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Atlas Copco Compressor AB</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Atlas Copco Tools Sverige</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Biltema</td>
<td>No, they have purchasing in China but no sales there</td>
<td>No</td>
</tr>
<tr>
<td>Claes Ohlsson</td>
<td>No, they have purchasing in China but no sales there</td>
<td>No</td>
</tr>
<tr>
<td>Ericsson</td>
<td>No</td>
<td>Yes, it was during the interview that we found that they did not fit our profile.</td>
</tr>
<tr>
<td>Fagerhults</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>H&amp;M</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Haldex</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Hemtex</td>
<td>No, they have purchasing in China but no sales there</td>
<td>No</td>
</tr>
<tr>
<td>Husqvarna</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>IKEA</td>
<td>Yes</td>
<td>No, we could not interview a representative with the right knowledge in time</td>
</tr>
<tr>
<td>Jula</td>
<td>No, they have purchasing in China but no sales there</td>
<td>No</td>
</tr>
<tr>
<td>KP System</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Lindex</td>
<td>No, they have purchasing in China but no sales there</td>
<td>No</td>
</tr>
<tr>
<td>Nefab</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Nordic Light</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>NOTE AB</td>
<td>Yes</td>
<td>No, they did not want to give out information about their operations in China due to competition.</td>
</tr>
<tr>
<td>Perstorp</td>
<td>?</td>
<td>?</td>
</tr>
<tr>
<td>Rusta</td>
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<td>No</td>
</tr>
<tr>
<td>Scania</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Tetra Pak</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Åhlens</td>
<td>No, they have purchasing in China but no sales there</td>
<td>No</td>
</tr>
</tbody>
</table>
Appendix B – Interview Template

1. Could you please introduce yourself and tell us a little about your role in the [company name] and its operations in China?
2. What does the company’s business activities does [company name] currently have in China?
3. Could you tell us about [company name]’s process of entering China?
4. When did [company name] first enter China?
5. Why did the company decide to enter China?
6. When was the first production facility opened?
7. When did the company set up its first sales office?
8. When was the first sale made/first contract awarded?
9. What percentage of the production in China remains in the country for the Chinese market and how much is exported to other markets?
10. What percentage of the Chinese production do you predict will stay in China in the future?