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# Exploring the Trend of Near-Sourcing to Eastern Europe

The Case of Swedish Manufacturers

Paper within: Master Thesis in Business Administration

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*Emelie Domeij and Gunita Laurson  
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## Master's Thesis in Business Administration

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### **Abstract**

Outsourcing has been a way for firms to reduce their cost of production and enabling them to focus on their core competencies for decades. As the total costs for manufacturing in China – the most prominent outsourcing location, are increasing due to unfavourable market changes, which in turn leads to loss of the competitive advantage, European companies are more and more often realizing and pursuing the benefits of ‘near-sourcing’ their manufacturing operations to Eastern European countries.

This paper is a study of outsourcing decisions related to specific products in the Swedish manufacturing industry, how the product characteristics identified through the Portfolio Model of Supplier Relationships, and how the dimensions of the CAGE Dimensions Framework affects such decisions.

Primary data was collected through three qualitative, semi-structured interviews with respondents from Swedish manufacturers currently outsourcing to China and/or Eastern Europe. The data was analysed through categories obtained from thorough literature review, where theoretical models were found as a foundation for the research questions that were established.

The research revealed that companies do follow the advised sourcing strategies for specific product characteristics. It serves as a good starting step, but can be developed into different directions. The leverage products were outsourced to China and Eastern Europe, while strategic items were also outsourced to Eastern Europe. However, some leverage items outsourced to both countries had some of the characteristics of a strategic item. The benefits from economic distance were the main advantage of production in China, whereas cultural and administrative distance had a negative impact. The economic distance for Eastern Europe provided benefits as well, even though these benefits were not as substantial as in China. The political distance served as both a positive and negative factor in Eastern Europe – positive due to its membership in European Union (for some of the countries) and negative due to high levels of corruption.

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# I Introduction

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*This chapter introduces the reader to the changes within international outsourcing practices and how these changes have been predicted to influence the choices of sourcing locations in the near future.*

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## I.1 Moving From Far-Sourcing to Near-Sourcing

Outsourcing has been the primary driver of business transformation worldwide since the mid-1980s (Kathawala, Zhang & Shao, 2005; Mol & Kotabe, 2011). However, from the mid-2000s there have been two noteworthy interlinked changes within the outsourcing practices which are predicted to grow in significance in the future.

The first change is presented by the data that offshore outsourcing is predicted to grow by 20 percent annually between the years 2010 and 2015 (Oshri, Kotlarsky & Willcocks, 2009). Nevertheless, while the levels of offshore outsourcing are steadily raising (Oshri et al., 2009), the certainty and pace of changes in the economic market have become unpredictable (Eisenhardt, 2002). The ever-growing customer sophistication, volatility of transportation-related costs, quality concerns and increasingly complex requirements for distribution continue to challenge the existent sourcing practices (Russell & Smith, 2009; Leach, 2012; Eisenhardt, 2002). All these factors put together with the continuously growing necessity for even higher added-value for end-customers (Berglund, van Laarhoven, Sharman & Wandel, 1999) have forced many companies to look at new possibilities to regain and maintain competitive advantages whose life-times are diminishing faster than ever before (Eisenhardt, 2002).

One of the increasingly proposed strategic changes for manufacturers to overcome these challenges is to outsource their production closer to their domestic country and/or point of consumption, in comparison to the currently dominant far-sourcing strategy, when the sourcing is done from geographically very distant countries (Tagliabue, 2007; Hoffman, 2008; Martin & Holweg, 2011; Bohn, 2012; Leach, 2012). This increasingly popular type of sourcing, when organizational activities are relocated to a relatively close lower-cost country, is called nearshoring or nearshore outsourcing depending whether the subsidiary is owned or provided by a third party (Oshri et.al, 2009). From now on and throughout the rest of the paper the term nearshore outsourcing will be shortened and referred to as near-sourcing.

While large manufacturing firms have outsourced manufacturing for decades (Kathawala et al., 2005; Kumar et al., 2009), the second change within outsourcing practices is that companies of medium and even small sizes are increasingly outsourcing their manufacturing, a core business process, instead of mainly non-core, peripheral activities that were subject to outsourcing in the past (Kathawala et al., 2005; Kumar & Kopitzke, 2008, Mol & Kotabe, 2011). From the mid 1980's, China has evolved into the most prominent offshore destination for manufacturing operations for companies all over the world (Ohmae, 2005; Alon, Herbert and Munoz, 2007), thus making it applicable as a benchmark for studying outsourced manufacturing activities. Outsourcing has always been considered to be especially economically efficient for labour-intensive, low-margin, high-volume products (Kumar & Kopitzke, 2008) and the manufacturing expenses for these type of goods mainly consist of the cost of labour. Therefore, China's most obvious advantage over the industrialized world has always been based on and justified by the much lower labour costs alone (Engardio, Arndt and Foust, 2006; Kumar and Kopitzke, 2008; Ferreira & Prokopets, 2009). Over the years the low-cost sourcing pattern of China has been successfully replicated and

is used over a variety of industries ranging from retail toys to industrial parts (Jacoby & Figueiredo, 2008).

## 1.2 Problem

Conversely, the steep increase of foreign direct investment (FDI), which followed the establishment of offshore manufacturing factories, has helped the regions of China with the highest ease of access to significantly industrialize (Fung, Iizaka & Tong, 2002; Taube & Ogutcu, 2002; Kang, Wu & Hong, 2009). The industrialization can be presented by the wage increases in China which have been reported to be between 20 (Bohn, 2012) and 30 percent annually (Leach, 2012), and the annual inflation rate in China has been around six percent (Hintze, 2011), which in turn considerably amplifies manufacturing costs with every year (Barboza, 2010; Leach, 2012). Ocean freight costs from China had risen by 135 percent between 2005 and 2008 and are continuously increasing (Ferreira & Prokopets, 2009).

The Chinese government has implemented lower export rates to follow the re-orientation strategy to shift the economy away from foreign demand dependence (tradingeconomics, 2012). This means that when the goods from China are brought to the EU market, the low cost advantages are eliminated because of the EU import tax. Therefore, while the wage savings in China are still considerable in comparison to the Western world, their overestimation tends to be very common among manufacturers (Hogan, 2004; Kumar & Eickhoff, 2005). Other issues and trade-offs of both qualitative and quantitative nature such as currency risks of the undervaluation of the Chinese yuan (Kumar & Eickhoff, 2005; Leach, 2012), piracy (Ferreira & Prokopets, 2009) and infringement of intellectual property rights (Sang-Eun, 2008), quality concerns (Biederman, 2006), labour rights, lead times and cultural and language differences (Wendell, 2009) must be taken into account.

However, the most underrated risk when far-sourcing manufacturing in China is inventory obsolescence, which is continuously increasing in vulnerability and costliness due to declining product life-cycle and lead-time (Kumar & Eickhoff, 2005; Das & Handfield, 1997). According to a recent research, 56 percent of companies which have outsourced their manufacturing operations, mainly to East Asia, have encountered a noteworthy increase of total landed cost (TLC) instead of the predicted cost reductions (Kumar and Kopitzke, 2008; Hogan, 2004). This increase of TLC is directly influenced by the lack of visibility over the increased supply chain distances (Ferreira & Prokopets, 2009) as smaller buffer stocks at the point of consumption leave less room for error (Kumar & Eickhoff, 2005).

All the factors mentioned above combined with the fact that Internet, e-commerce and information technologies have made outsourcing accessible even to the small manufacturers (Kumar & Kopitzke, 2008), have diminished the purely low-cost based manufacturing perspective of China (Leach, 2012). If once outsourcing to China created a competitive advantage, then nowadays, when the majority of companies and competitors have followed the same strategy, firms have arrived back at a starting point where little strategic difference exists (Ferreira & Prokopets, 2009). After interlinking the two major changes within the outsourcing practices and strategies, it becomes clear that companies which want to regain a competitive advantage and be demand responsive can pursue a restructuring of their far-shore outsourcing strategies in the close future to near-source countries in order to deal with the new market conditions and challenges as an option (Bussey, 2011).

It is difficult to approximate previous research of near-sourcing as various terms like regionalization and strategic offshoring are sometimes used as synonymous. However, it is

clear that near-sourcing has not been studied in such a great detail as outsourcing so far. To emphasize the fact, there were 8125 articles published on outsourcing in 2011 alone on the data base ABI/INFORM while there are less than 400 articles published on near-sourcing since 1999. Similarly to the research of outsourcing, the majority of the existing publications are mainly positioned from the United States (U.S.) viewpoint and its considerations to change sourcing locations from China (or Asia) to South America (mainly Mexico) in the near future (see Biederman, 2011; Bohn, 2012; Leach, 2012; Mongelluzzo, 2012).

There is a general assumption that offshore practices in Europe while existent are not as widespread as in the U.S (Werner, 2009). The majority of European manufacturers who source their operations abroad do so in the nearby post-Soviet – Central and Eastern European countries (Werner, 2009; Kumar, Kwong & Misra, 2009), rather than moving their production facilities to the far Asia to begin with (Farell, 2004; Trampel, 2004), with the exception of British (Kumar, Kwong & Misra, 2009) and Scandinavian companies (Werner, 2009). The majority of existent research focuses on certain company, country or industry specific case studies (e.g. Eriksson, Backman, Balkow & Dahlkild, 2008; Cairns & Roberts, 2007; Werner, 2009; Kornet, 2011). As a result, near-sourcing on a broader scale – what differentiates the decision of a certain location to manufacture a certain type of product from a European perspective, has received limited attention. Additionally, a concept of Scandinavian management, which significantly differs from the management practices within non-Scandinavian countries, has been brought to attention since the 1980s (Sjøborg, 1985; Railo, 1988). While certain differences among the management styles in the Scandinavian countries have been acknowledged (Lindkvist, 1988) they are seen as minor in comparison to the similarities (Hofstede, 1980, 1991; Ronen & Shenkar, 1985; Grenness & Joynt, 1996; Schramm-Nielsen, 2000; Zander, 2000) thus making it hard if not impossible to draw all-inclusive European-wide conclusions on the matter to begin with. Put together the two changes within the sourcing strategies, practices with the differing management approaches, and the existent literature, there is clearly a gap in research on the dynamics and changes within far and near-sourcing strategies of Swedish manufacturers.

Eastern European countries have already become an attractive option for Swedish manufacturers to source production at (see Hestra, 2012; Official website of Lindab Group, 2012; Andersson, 2007; Skillingaryd.nu, 2012). However it is not known which factors exactly influence the decision to change the manufacturing locations from far to near, and whether there really is a shift as in the case of the U.S. Raw material sourcing strategies and supplier selection criteria are highly dependent on the market strategy of the end-product (Kamann, Karasek & El-Kadi, 2001; Kamann, 2007). Thus, specific product and country characteristics must be taken into account to investigate which are the key factors that influence the decision to source manufacturing from Sweden to Eastern Europe instead of China.

### **1.3 Purpose**

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The purpose of this paper is to investigate how product characteristics and different expected and experienced distance factors influence Swedish companies to near-source manufacturing to Eastern Europe rather than far-source to China.

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### **1.4 Delimitations**

Eastern Europe can be defined as Belarus, Bulgaria, Czech Republic, Hungary, Moldova, Poland, Romania, Russia, Slovakia and Ukraine, while Estonia, Latvia and Lithuania (the Baltic States) are classified as Northern Europe (United Nations Statistics Division, 2012;

EuroVoc, 2012). However, the categorization of countries varies between different agencies, and at times the Baltic States are classified as part of Eastern Europe (World factbook, 2009). The Baltic States of Estonia, Latvia and Lithuania will be categorized as Eastern Europe throughout this paper, while Russia, due to the variation from the other post-soviet countries in terms of its physical and economic size and complexity, and Belarus due to its autocratic regime (Burnell, 2010; European Commission, 2012b) will not be included in the research.

## **1.5 Intended Contributions**

The paper supports the point of view that a more holistic supply chain view should be taken into consideration if managers are to optimise their results for outsourcing. With the help of the set purpose, the authors of the thesis will identify and examine the factors that drive near-sourcing and what implications distance has on outsourcing decisions. The key factors of why a company might change its outsourced manufacturing operations from China to Eastern Europe or remain located in the first will be analysed and weighted. The authors seek to add a qualitative study to a phenomenon that has been largely dominated by quantitative studies, in the pursuit to find a more in-depth understanding.

## **1.6 Structure**

Hierarchy of concepts and the theoretical framework are explained in following two chapters before forming research questions. Part four of the thesis explains and justifies the research methods chosen for primary data collection. Chapter five presents the case studies and the empirical data gathered for the research which is followed by an analysis and a discussion of the data in part six. The last part of thesis summarizes final conclusions of the research and possible future research areas to deepen the knowledge and credibility on the subject proposed.

# **2 Hierarchy of Concepts**

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*The following section defines and classifies the terms used throughout the paper.*

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There is a vast amount of materials published and research done on sourcing in the last couple of decades in trade magazines, academic journals, and books (see Hult & Chabowski, 2008; Russell & Smith, 2009 for an overview). While nearly every researcher and business practitioner has been directly or indirectly introduced to or engaged in sourcing processes (Oshri et.al, 2009; Mol & Kotabe, 2011; Jacoby & Figueiredo, 2008) and is familiar with the possible benefits it may bring if managed strategically, the various terms of sourcing are still scantily defined and inaccurately used by both (Oshri et al., 2009). To avoid any confusion or misinterpretation the specific terms used throughout this paper are classified in Figure 2.1 and defined as follows.

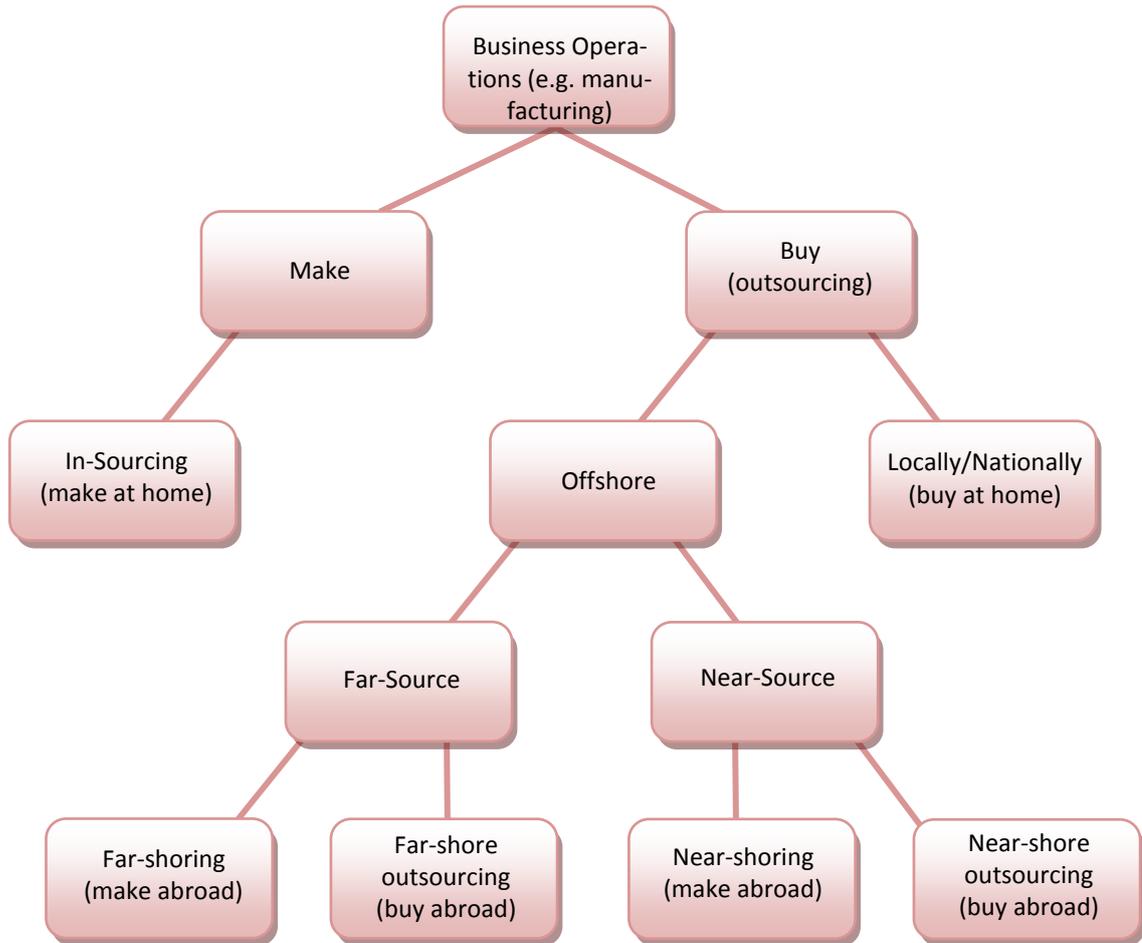


Figure 2.1

Classification of Sourcing.

### 2.1.1 Sourcing

Sourcing is the act through which a work is contracted or delegated to an external or internal entity that can be physically located anywhere. Sourcing includes various in-sourcing and outsourcing arrangements such as offshore outsourcing, captive offshoring, nearshoring and onshoring to name a few (Oshri et.al, 2009). Sourcing should be seen as a strategic philosophy of vendor selection in a manner that makes them an integral part of the buying firm for a particular component or part they are to supply (Zenz, 1994, p. 120), to support and improve the competitive advantage rather than simply focus on the lowest price for a material (Zeng, 2000).

### 2.1.2 Outsourcing

Contracting out previously in-house done functions (Snyder, 2005) to a third service provider, not necessarily abroad, for the management and completion of a certain amount of work, for a specified length of time, cost, and level of service (Oshri et.al, 2009). The decision making process for outsourcing usually starts with a consideration of two issues; “make” or “buy” and do it at “home” or “abroad”. Four types of outsourcing may result: an integrated process (make at home), a traditional subcontracting (buy at home), offshoring (make abroad), and international outsourcing (buy abroad) (Fontagne, 2009).

### 2.1.3 Offshoring

A sourcing process when companies undertake some of their activities and/or operation at offshore locations instead of their home countries (Murtha, Kenney & Massini, 2006). When the work is offshored to a centre that is owned by the organization it is referred to as a *captive offshoring*. When the work is offshored to an independent third party it is referred to as an *offshore outsourcing* (Oshri et.al, 2009; Kaiser & Hawk, 2004). Offshoring is just one type of the more general theory of global distribution of work (Kumar, van Fenema & Von Glinow, 2005; Shapiro, Von Glinow & Cheng, 2005; Kumar, Van Fenema & Von Glinow, 2009; Lewin & Peeters, 2006a, 2006b).

### 2.1.4 Nearshoring and Nearshore Outsourcing

The organizational activities are outsourced to a supplier in a foreign, lower-wage country yet are relatively close in distance and/or time-zone differences (Oshri et.al, 2009; Carmel & Abbott, 2007). *“The customer expects to benefit from one or more of the following constructs of proximity: geographic, temporal, cultural, linguistic, economic, political, and historical linkages”* (Carmel & Abbott, 2007, p. 44). The majority of publications address both terms interchangeably (Oshri et.al, 2009), therefore, to avoid the common confusion with the term offshoring the term near-sourcing will be used throughout this paper instead.

## 3 Frame of Reference

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*This section introduces and justifies the theories chosen to fulfil the purpose of the paper before forming the specific research questions and presenting the research model.*

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### 3.1 Introduction and Justification of Theories

Buyer-supplier relationships in literature are usually treated from a single relationship or a single type of relationship point of view (Elram & Olsen, 1997). Whereas this approach might have been satisfactory in the past it is no longer sufficient in the volatile world we live in today (Eisenhardt, 2002), due to increasing risk mitigation (Burnson, 2011). A development and utilization of a supplier relationship management model for the entire purchasing portfolio is invaluable for any manufacturing company to ensure a strategic allocation of the scarce resources between various purchasing relationships (Elram & Olsen, 1997).

A typical portfolio model works in the following way – after decision makers have assigned weights to the various dimensions the model suggests a variety of potential action plans. Consequently, a categorization not interdependent of the subjects of study are made, which with no assistance on decision making, results in impracticality and uncertainty (Elram & Olsen, 1997) as no company has the resources to implement all proposed strategies. The Portfolio Model of Supplier Relationships however is developed on the notion that a company is a mutually dependent group of products and services from which each has a unique and supportive role (Elram & Olsen, 1997) to overcome these deficiencies (Day, 1977). The model thus strives to identify one strategically appropriate plan to improve the distribution of scarce resources (Elram & Olsen, 1997).

The Portfolio Model of Supplier Relationships is built upon two different widely accepted models by Fiocca (1982) and Kraljic (1983). First, a customer account management classification is created based on the strategic importance and the difficulty to manage the account. On the second step, customer attractiveness and strength of the buyer-supplier relationship are used to analyse the key-accounts in-depth (Fiocca, 1982). The model is taken a

step further and combined with specific purchasing strategies from the various buyer-supplier relationships depending on product classification. Product classification is based on the dimensions of the profit impact of purchase and the supply risk (Kraljic, 1983).

The choice of a purchasing model for the theoretical basis of the study is justified by its ability to leverage and synergise different items via coordination of the sourcing patterns of rather independent strategic business units within a company (Carter, 1997; Gelderman & Van Weele, 2002), thus making it appropriate to use for analysis of different sourcing destinations of a single company. Secondly, the model differentiates the overall procurement strategy with diverse strategies for various supplier groups (Lilliecreutz & Ydreskog, 1999), complementing the conclusions of researchers and practitioners that different products/product groups require different sourcing strategies. Moreover, the matrix has been developed to guard managers against supply interruptions and guide through globalization, economic and technological changes (Kraljic, 1983), hence, directly applying to the characteristics of near-sourcing which is driven by the increasing market volatility, uncertainty, shorter lead and product-cycle times. All of these dimensions are important and necessary to be taken into account when choosing the decision whether and where to outsource (Kumar & Kopitzke, 2008). One of the main criticisms directed towards portfolio models arises from their limitation to analyse products only in a dyadic context, in other words, they do not include all of the aspects of a buyer-supplier relationship from a network perspective (Dubois & Pedersen, 2002). To overcome this shortcoming CAGE Distance Framework has been chosen as additional theory to encompass the entire supply chain and the impacts a sourcing decision has on it.

Due to the fact that outsourcing and off-shoring are not new business strategies (Kathawala et al., 2005), companies tend to choose their offshore locations based on the experience of other firms which source in the specific destination (Wendell, 2009), as new research is costly in terms of time, finances and labour force (Elram & Olsen, 1997). This approach leads to consequential exaggerations of the attractiveness of certain markets and their strategic fit to the strategy of the individual firm (Ghemawat, 2001). Since one size does not fit all, this approach can end incredibly costly due to the unpredictable and fast changes on the market (Eisenhardt, 2002). The most well-known and used analytical tool for decisions on entering foreign territories is the country portfolio analysis (CPA), which focuses mainly only on the economic strength and growth of the chosen country, and ignores the fact that the majority of risks and costs arise from the obstacles created by distance (Ghemawat, 2001). The CAGE Distance Framework is created to overcome this shortcoming and summarizes the key success factors of an offshore location in four groups – cultural, administrative/political, geographical and economical. The major strengths of the approach therefore are that it covers all dimensions of strategic management, can be applied to a market of any size (e.g. entire country or specific region), includes information of the entire supply chain network within the chosen location not only relationship specific, and stresses the focal role of the individual firm and its specific business strategy. However, the different distances have different importance and impact on different types of businesses. Moreover, the framework includes all so-far identified factors and is therefore very broad. Decision makers must have knowledge what affects their business the most to fully exploit the CAGE Distance Framework and the analysis will be very subjective (Ghemawat, 2001).

## **3.2 Portfolio Model of Supplier Relationships**

### **3.2.1 Step 1 – The Strategic Importance of the Purchase**

The strategic importance of a specific purchase is based on the identification and assessment of the firm. The strategic importance is divided into factors of competence, economy and image. Whereas these factors vary among different companies, a list of all possible factors is presented in Appendix 1.

The competence factors relate to the degree to which the purchased item is considered as a core competency of the firm. The strategic importance is determined by the closeness of an issue to the core competencies – the closer the interdependence, the more superior the strategic importance of the item purchased (Fiocca, 1982). Specialized investments, know-how and technical advantages are all matters to be considered as a part of core competencies (Reve, 1990) An analysis whether the purchase can strengthen the technological or knowledge base of the buying company must be taken into account as well (Fiocca, 1982).

The economic importance of the purchase in terms of its monetary value and how it affects profit are determined by the economic factors. Evaluating to what degree the items bought are important to get leverage with the supplier for additional procurement is an integral part of these factors in order to see the interdependencies between the purchases. The effect of a purchase on the reputation of a firm (Fiocca, 1982), as well as safety and environmental concerns (Tate & Ellram, 2009), are assessed under the image factors.

### **3.2.2 Step 2 – Difficulty of Managing the Purchase**

In contrast of the determination of strategic importance of a purchase, external factors must be examined to see the difficulty of managing a specific purchase situation. The external issues address the extra effort that has to be put in by a firm when managing the purchase. The factors describing the latter issue are divided into three categories of product, supply market characteristics and environmental characteristics. Just like in case of the previously presented factors these also vary among individual firms (see a comprehensive list in Appendix 2) (Fiocca, 1982).

Novelty and complexity of the product/service to be purchased are aspects of the product characteristics. This means that the newer or complex the item purchased, the more effort has to be put in to the management of the supplier relationship (Fiocca, 1982). Product complexity is derived from six sub-parts which all must be scrutinized for an all-inclusive analysis. These sub-parts are: manufacturing complexity – relays on the number of parts and subassemblies, functional complexity – encompasses the difficulties in producing the product; specification complexity – analyzes the need of extended period of trial. A need for a training period to use a product is referred to as application complexity, complex commercial deals in transactions create commercial complexity, and political complexity arises from political considerations (Homse, 1981).

Supply market characteristics are: the power of the supplier analysed through resource dependency (Pfeffer & Salancik, 1978), number of available suppliers, size of a company (Campbell, 1985), the substitutability of items (Krapfel, Salmond & Spekman, 1991), and the supplier's competence in terms of technology and commercial ability (Fiocca, 1982).

Finally, the overall risk and uncertainty concerning the purchase itself is assessed by using the environmental factors (Fiocca, 1982). Two types of risk can be considered here: the commercial risk and technological risk. The likelihood of finding price-performance niches

on the market account for the commercial risk while the technological risk is created by the possibility of the technology being brought to the market (Ring & Van de Ven, 1992). Estimation of opportunistic behaviour in the supply market is the last but not least aspect of risk to be considered (Fiocca, 1982). In general risk depends on information, control, and time available while perceived risk relies on the level of uncertainty (Ring & Van de Ven, 1992). Uncertainty can be either classified as market uncertainty depending on the variety of solutions available on the market, or as technical uncertainty influenced by the technical content of the offered solutions (Hedaa, 1993).

### 3.2.3 Step 3 – Portfolio Model and Kraljic’s Matrix

Once the importance of the factors presented above has been determined, decision makers must weight them among one another on their significance to the company. While highly subjective, this is the most important part of the model application (Fiocca, 1982) and the entire scale of measures must be used to create strategically important conclusion (Olsen & Ellram, 1997). Various weight assignment methods can be found in supplier selection literature (see Narasimhan, 1983; Thompson, 1991; Min, 1994). The resulting evaluation is next presented in a portfolio model which is a combination of portfolio models by Fioca (1982) and Kraljic (1983). Purchasing professionals differentiate between various separate strategies for each quadrant of the matrix. The main idea of the matrix is supply risk minimization and buying power utilization to the maximum (Kraljic, 1983).

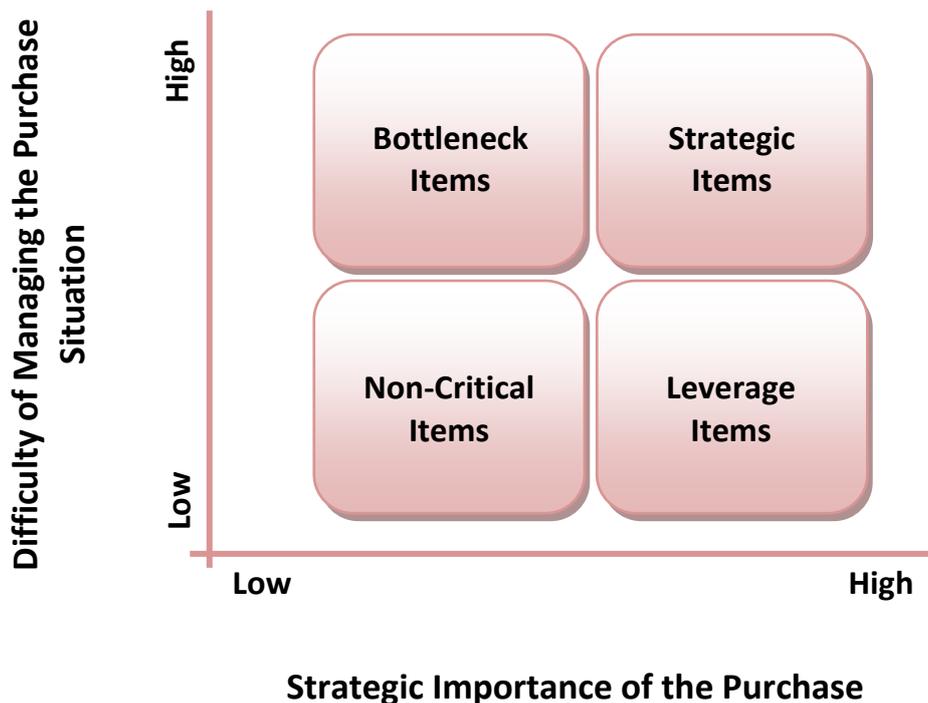


Figure 3.1 Portfolio Model of Supplier Relationships (Olsen & Ellram, 1997).

#### 3.2.3.1 Leverage Items

Easy to manage but strategically important purchases fall into this category. Leverage items allow the purchaser to utilize full bargaining power for the best price by calling for tenders, tough negotiations, target pricing and product substitution as the materials have a wide supplier base able to provide identical quality and performance (van Weele, 2000; Arabzad & Ghorbani, 2011; Gelderman & van Weele, 2002; Kraljic, 1983). A buyer-supplier relationship goal for this type of buys is the creation of common respect and systematic com-

munication for future deals, while not investing in specific relationships. Managers should strive to recognize particular added-value of the purchase and disperse the supplier and volume base across various product lines. To achieve lower costs of materials suppliers are selected based mainly on price and availability. The total monetary value of purchases in this category is high due to their strategic importance, therefore, a low-cost supplier is crucial. The key-performance criterion for leverage items are the management of cost and material flow (Kraljic, 1983).

The items from the leverage quadrant is the starting point when deciding what and where to outsource due to their great financial impact on the overall business of an organization and the availability of numerous suppliers. Since the “leverage items” have a great profit impact, the potential cost advantages, profitability and return on investment are also expected to be significant if outsourced strategically. For this type of items, companies are advised to source globally and buy locally (international/global outsourcing) (Kamann & Van Nieulande, 2010).

### **3.2.3.2 Strategic Items**

Suppliers from which products of this category are bought from should be seen as an extension of the buying company because of the strategic importance of purchases and difficulty of their management. Supplier selection should not be based on price but rather on the total cost (Kraljic, 1983). An ideal buyer-supplier relationship should be very close and integrated. Strategic and long-term relationships are vital for the safety of the business (van Weele, 2000; Arabzad & Ghorbani, 2011), thus, the items should be bought from a small number of suppliers or even a single one (Kraljic, 1983). If the purchasing firm has power dominance it should utilize it to minimize costs and supply risks. When the supplier is dominant the buying organization should be defensive and look for substitute goods or suppliers. To ensure integration between the buyer and supplier a joint product development, early supplier involvement and long-term value focus should be supported while poor performance costs need to be decreased. The key-performance criterion for strategic items is long-term availability (Kraljic, 1983).

By theory “strategic items” should not be sourced from lower-cost countries because of their high profit impact on the company and limited availability of suppliers. However, outsourcing is possible if suppliers with fitting capacity and capability are found. Suppliers for this type of items should be selected via an agent to ensure required standards and skills (Kamann & Van Nieulande, 2010).

### **3.2.3.3 Bottleneck Items**

To effectively control purchases of low strategic importance but high difficulty to manage, the buying firm should, first of all, try to find substitutes as these items tend to cause a lot of risks and problems (Gelderman & van Weele, 2002; Kraljic, 1983). If substitution is impossible purchases should be standardized (Kraljic, 1983). The buying firm should strive for volume insurance via means of a guaranteed contract with the supplier, supplier control, security of inventories, and back-up plans (van Weele, 2000; Arabzad & Ghorbani, 2011; Gelderman & van Weele, 2002) to avoid disruptions of production. To lower the costs of operations, the buying firm may try to establish relationship with a focus on concurrent engineering and involve the supplier to analyse the value of the relationship. The key-performance criteria for bottleneck items are management of costs and reliable short-term sourcing (Kraljic, 1983).

As in the case of “strategic items” the goods falling into the “bottle-neck” quadrant in theory should not be sourced from lower-cost countries. However, if possible suppliers can be found firms should choose the one within the closest geographical distance (near-source) to decrease costs and increase reliability (Kamann & Van Nieulande, 2010).

#### **3.2.3.4 Non-Critical Items**

The category of non-critical items consists of purchases which have low strategic importance and are easy to manage. These items necessitate efficient processing and order volume, and are advised to be controlled by keeping an optimal level of inventory (Arabzad & Ghorbani, 2011; Gelderman & van Weele, 2002). The ideal buyer-supplier relationship for this kind of purchases is based on consolidation and standardization (Arabzad & Ghorbani, 2011; Kraljic, 1983) as there is a large number of suppliers and/or substitute products available (Gelderman & Mac Donald, 2008). The low-value items with a lack of good procurement strategy would lead to increased purchasing costs (Gelderman & Mac Donald, 2008), therefore, the relationship strategy should aim to decrease both the number of suppliers and duplicate products/services to create a relationship that requires no management and reduces administrative expenses (Van Weele, 2000). This can be done through the implementation of blanket order, system contracting or small purchase order charge card (SPOCC) where an item is purchased in a transaction-based manner depending on price. The key-performance criterion for strategic items is functional efficiency (Kraljic, 1983).

The items from the “non-critical” quadrant are not advised to be outsourced due to their low value for the overall business. Their organizational costs (e.g. ordering, expediting, paying, handling) most of the time surpass the cost of the purchase, therefore, a local sourcing strategy should be applied if needed (Kamann & Van Nieulande, 2010).

### **3.3 The CAGE Distance Framework**

While some argue that the world is flat and globalization with the help of information technology has created a boarder-less and international environment where distance no longer matters (Friedman, 2005), the data show that this view is highly exaggerated and reality is not quite the same, especially when it comes to doing business in a foreign country (Ghemawat, 2001; 2008). Information technology undoubtedly has changed many aspects of international business operations in terms of speed and accessibility, but companies have to be aware of and assess the implications of distances that still exist in case to be successful in cross-border operations. A broad framework to summarize the implications of cultural, administrative, geographic and economic distance (CAGE) has been developed to help companies analyze their strategic fit with specific foreign markets of their choice. This model shows how the different distances can restrict or improve the effectiveness of the relationship between the firm and its supplier in cross-border partnerships (Ghemawat, 2001).

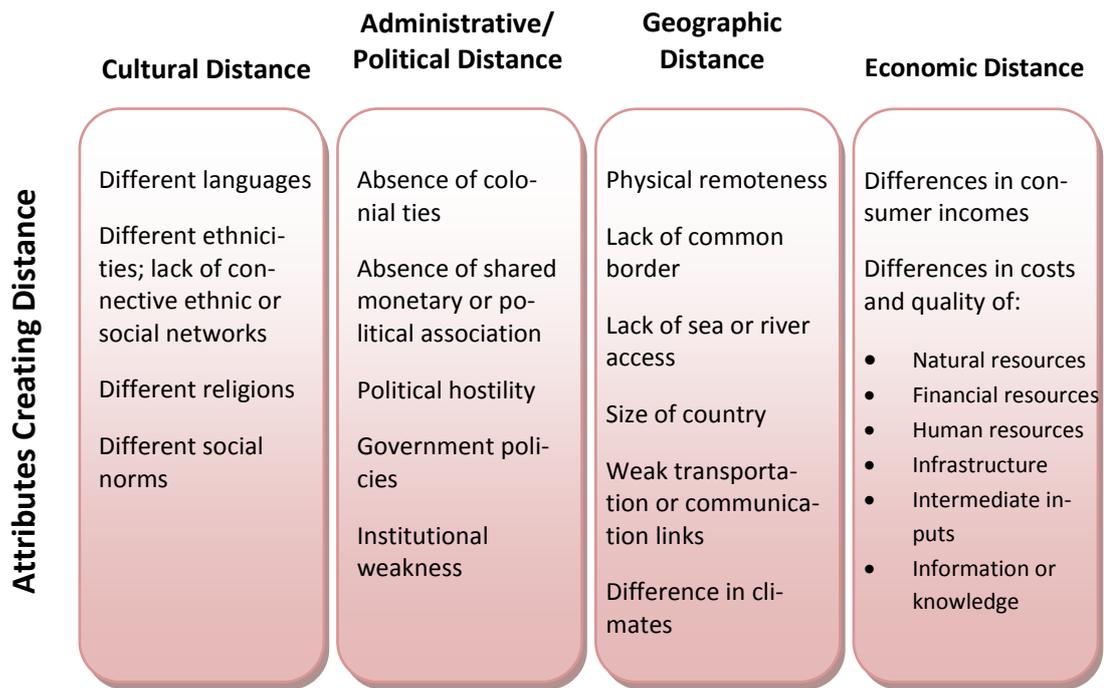


Figure 3.2 CAGE Distance Framework (Ghemawat, 2001).

### 3.3.1 Cultural Distance

The main obstacle for successful offshore outsourcing is cultural differences (Wendell, 2009) which are defined by language, social norms, traditions, and customs (Carmel, 1999). The culture of a country and a company influences how people interact with each other, and companies sharing the same culture and language will have an advantage to overcome communication problems (Ghemawat, 2001; Asta, 2005). Language barrier has been recognized as a very high risk for the success of international sourcing (Birou & Fawcett, 1993; Schniederjans & Zuckweiler, 2004; Carmel & Abbott, 2007; Boardman, Berger, Zeng & Gerstenfeld, 2008). While most of the business professionals in developed world can speak the current *lingua franca* – English (Frankel, 1995), the knowledge levels, especially the ability to use the language, in low-cost countries where the majority of offshore manufacturing is outsourced to is poor (Wendell, 2009).

Hofstede (1980) has classified social norms in five dimensions – power distance, uncertainty avoidance, individualism versus collectivism, quantity versus quality of life, and long-term versus short-term orientations. Asian cultures are generally characterised by focus on the quality of life, long-term orientation, high power distance, high uncertainty avoidance and collectivism, while Western cultures tend to emphasize the contrary (Hofstede, 1980, McGregor, 2005; Ross, 1999). Even little details like business ethics and importance of written contracts differ greatly (McGregor, 2005). In contrary, Eastern European cultures, while differing among themselves (Coffe & van der Lippe, 2009), have been acknowledged as closely related to those of Western Europe and praised for their high management skills (McNulty, 1992).

### 3.3.2 Administrative and Political Distance

Administrative distance determines the required time and ease for a foreign company to start and run its business, the extent of actual power and say of management of the indi-

vidual company within a foreign land, and the safety and sustainability of the business (Ghemawat, 2001).

Historical and political affinity (e.g. colony-colonizer) between two countries has been found to be a pre-determinant for higher chances of successful partnership due to prior experience and references (Ghemawat, 2001; The World Bank, 2010). Unsurprisingly, policies, trade agreements/trade liberalization (Ghemawat, 2001), common currency and political union are favourable for cross-border movement of goods as they ease the administration and management costs and decrease stand-by and clearance time of goods in transit (The World Bank, 2010). In contradiction, various tariffs (Fraering & Prasad, 1999; Ghemawat, 2001) and country-specific trade quotas can decrease the appeal of a country as offshore destination (Ghemawat, 2001).

Dealing with different regulations and laws in a foreign country can increase the compliance risks and reduce profits if violated (FDIC, 2004). Regulatory compliance and transparency are important factors that drive change in international supply chains as well as customs regulations compliance (Hameri & Hintsa, 2009), therefore, applicable and supportive government policies for foreign companies are important (Ghemawat, 2001; The World Bank, 2010; Lysons, 2000; Xu, 2009). Governments of low-income countries tend to be more favourable to local and/or regional firms (The World Bank, 2010), which extends the time to meet legal requirements while dealing with bureaucracy, may include previously unknown fees or bribery, limit the scale of business, and decrease the decision-making power of the individual company (Ghemawat, 2001). The exploitation of raw materials of the country where the outsourced activities are performed can sometimes be seen as if the foreign company is exploiting the natural resources. This nationalistic behaviour can become a difficult issue for the company to guarantee and continue its operations (Ghemawat, 2001). Low-cost countries (LCC) do not have the same requirements of labour health and safety, and environmental standards. Therefore, companies from the developed world must be very cautious when selecting a supplier in LCC to guard themselves against brand and reputation damage (Eisenhardt, 2002; Fitzgerald, 2005) caused by the growing awareness among consumers on environmental issues (Hameri & Hintsa, 2009) and human rights in developing world (Eisenhardt, 2002). Firms which offshore manufacturing must also comply with pollution regulations, waste management and safety standards of the foreign land (Kumar et.al, 2009).

The laws concerning security concerns have been given more attention since 9/11, which has affected the global trade environment (Hameri & Hintsa, 2009). This has led to an increased attention on and importance of possible social conflicts (The World Bank, 2010) and political stability of a country (Schniederjans and Zuckweiler, 2004) when deciding on the sourcing location to ensure safe, sustainable and **disrupted** business operations (Ghemawat, 2001; FDIC, 2004).

### **3.3.3 Geographic Distance**

The geographical distance between countries can relate to distance between borders within the country, the size, and the access to sea or river transportation, as well as infrastructure relating to communication and transportation which all consequently affect transportation costs and communication (Ghemawat, 2001). Transport and communication refer to road, rail, water, and air transport, post and telecommunications, as well as television and print media (The World Bank, 2010). Companies using Just-In-Time (JIT) strategy are most vulnerable to and dependent on these systems (Fraering & Prasad, 1999). Information and data management will be increasingly important to focus upon due to more complex

supply chains that follow with globalization where the Internet and e-commerce will play an increasingly important role (Hameri & Hintsa, 2009). Technology can improve communication, collaboration and coordination, which closes the gap between different countries (Carmel & Abbott, 2007). Countries must invest in their information and communication technologies (ICT) and systems to be an attractive offshore destination in the future (Wendell, 2009).

Non-coastal countries as well as countries with no access to large economic centres (mostly LCCs), usually have thin traffic density and poor infrastructure. Therefore, the total freight costs within and from them are significantly higher than between developed countries (The World Bank, 2010), not to mention considerably longer lead-times especially so if the country is territorially large (Ghemawat, 2001). This explains why common borders or close geographical distance is becoming an increasingly favourable determinant on offshore decisions for efficient and effective supply chain strategy (Ghemawat, 2001). Additionally, the growing popularity of sustainable and green supply chains has resulted in the implementation of emission quotas (Hameri & Hintsa, 2009). Consequently the long supply chain distances are becoming even more expensive for companies which outsource manufacturing. Long lead times also create freight rate uncertainty (Leach, 2012; Ferreira & Prokopets, 2009) and require companies to maintain safety stocks (Fredriksson & Jonsson, 2009). Structural flexibility of the buyer company – the ability of the supply chain to adapt to fundamental changes in the business environment, which is growing in importance to remain competitive in the unstable market, is almost impossible to achieve over physically long supply chains (Martin & Holweg, 2011) Countries situated in areas where natural hazards and/or pandemics are frequent decrease its appeal for an offshore destination as supply chain disruptions are unpredictable (Hameri & Hintsa, 2009). In some cases, the different climate of a country can have an impact on a sourcing decision (Ghemawat, 2001).

Geographical remoteness is created by the physical distance and time zone differences (Carmel, 1999). Geographical dispersion has a significant impact on coordination and control as communication is less frequent, less unprompted and mostly done via electronic channels, thus, creating more room for misunderstanding and delays (Saric, 2011). Further complications to the communication process are added by significant differences in time zones between the two parties involved in the outsourcing relationship, as working hours do not match one another thus direct communication is not always possible (Wendell, 2009).

### **3.3.4 Economic Distance**

The differences in consumer incomes is an important factor for companies which plan to not only source from a certain country, but also to enter its market as it helps to predict potential consumer spending potential (Ghemawat, 2001) and economic growth (Wendell, 2009). For companies which do not necessarily wish to enter the foreign market, and where cost differences are essential, economic arbitrage can be used as a strategy to gain competitive advantage by acquiring cheaper natural and financial resources, infrastructure, labour rates and gaining access to knowledge and information in the offshore country during the manufacturing process (Ghemawat, 2001). However, a company also needs to keep in mind that the quality of such outsourced factors needs to be assessed. A poor level of quality which does not meet expected standards may result not only in unexpected re-manufacturing costs and supply delays, but may also terminate the outsourced process altogether (Jennings 1996; 2002; Min & Galle, 1991; Rodrigues, Bowersox & Calantone, 2005; Arvis et.al, 2007; Xu, 2009).

Continuously increasing expansion over foreign markets, which is followed by growing levels of consumption, has caused the prices of raw materials to rise. In this case, companies are looking for offshore countries which offer them the chance to explore and refine natural resources to stay competitive. Availability of raw materials within the country of manufacturing reduces costs for sourcing and shipping them from another location. Prices, availability and reliability of energy/electricity are crucial for the daily activities of any kind of business as they have a great impact of the total price of the product/service (Hameri & Hintsa, 2009). Companies must make sure that the location they have chosen for their sourcing activities meet the requirements, as various LCCs are still struggling with stable supply of power (The World Bank, 2010).

Low/lower manufacturing and labour costs are still one of the most dominant reasons why firms decide to offshore their production as they allow to create economies of scale (Hameri & Hintsa, 2009). Nevertheless, companies must first analyze whether the labour is skilled enough to meet the company-specific requirements (Ghemawat, 2001) and keep in mind that the average turnover rate in offshore jobs is higher (Kumar et.al, 2009), which both may require additional investment in training. The availability and quality of knowledge and information is more important for companies which do not outsource to only exploit cheaper labour, but also acquire new skills and technology via the process (Ghemawat, 2001). Currency stability is a risk factor not to be forgotten when sourcing from abroad. Unstable local currency can impact whether the supplier will be able to afford to complete the outsourced processes (Schniederjans & Zuckweiler, 2004). Additionally, if a country has high exchange rate volatility, the decision to source from such a country is often discouraged (Fraering & Prasad, 1999). The exchange rate will have an impact on the prices for materials, sourcing and plants (Aggarwal and Soenen, 1989).

Freight costs from low-income countries are higher than from developed countries due to their physical distances, however, the quality of it may impact the reliability, transit time and condition of goods delivered (The World Bank, 2010) even further. There are six performance areas how to analyze a logistics performance of a country – *“efficiency of customs clearance processes, quality of trade- and transport-related infrastructure, ease of arranging competitively priced shipments, competence and quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled or expected time”*. Nowadays, demand volatility and uncertainty require the supply chain performance to be reliable and predictable to stay competitive (Arvis, Mustra, Panzer, Ojala & Naula, 2007; Arvis, Mustra, Ojala, Shepherd & Saslavky, 2010). The success of international trade depends on the performance of the entire supply chain (The World Bank, 2010) as a delay of a single day reduces the trade by minimum one percent (Djankov, Freund & Pham, 2010). The necessary investment to build new or upgrade the available infrastructure requires extensive investment and time if it does not meet the requirements.

### **3.4 Synthesis of Theories and Research Questions**

The Portfolio Model of Supplier Relationships categorise the products based on the specific characteristics of the product and supply chain implications from an internal view of an individual firm on the entire supply chain of a certain outsourcing decision. The category of the product will be determined through the strategic importance of the purchase and difficulty to manage the purchase. It is also interlinked with the overall profit impact on the business from the specific product and the availability of suppliers meeting the criteria in a specific region. After the products are classified it is possible to determine their

supply chain implications and analyze the sourcing strategies based on the positioning of the product in the matrix.

*RQ<sub>1</sub>: How are the different product characteristics related to the decision to outsource to China?*

*RQ<sub>2</sub>: How are the different product characteristics related to the decision to outsource to Eastern Europe?*

The CAGE Distance Framework on the other hand looks at the purchase from an external level, where the dimensions and sub-factors assess the country specific factors to be considered when choosing country to outsource the processes to. Therefore, together these theories will give a better overview of the whole outsourcing decision process and why some products are seen as more suitable for near-sourcing than for far-sourcing from theoretical point of view. The Portfolio Model of Supplier Relationships will allow to test whether the sourcing strategies advised for the specific product categories are implemented in real life with efficient and effective results, thus, showing whether companies follow the same decision making process. The CAGE Distance Framework on the other hand, will allow to analyse the (in)appropriateness of the proposed and actual sourcing locations for the manufacturing of the specific products, and which of the distance factors are the most important for Swedish manufactures, for each of the locations. Therefore, the CAGE Distance Framework allows exploring what the after-math of the sourcing process to a specific location would be.

*RQ<sub>3</sub>: What is the impact of the cultural, administrative/political, geographical and economic factors specific to China that would determine whether a company should start, continue or discontinue outsourcing manufacturing in the country?*

*RQ<sub>4</sub>: What is the impact of the cultural, administrative/political, geographical and economic factors specific to Eastern Europe that would determine whether a company should start, continue or discontinue outsourcing manufacturing in the country?*

When combined, the theories show both upstream and downstream supply chain factors for a specific sourcing decision and will allow to conclude which the key factors are behind the reasoning why China may no longer be the best option for companies to offshore certain manufacturing processes to. The visualised Research Model shows the links and application of the chosen theories in reliance of forming research questions. Note that “non-critical” items are excluded from product classification in the model due to their characteristics and management applications. The low value of these items and ease of the management of their purchase is most effectively and efficiently exploited by local or in-house sourcing, which excludes them from the research on off-shore sourcing.

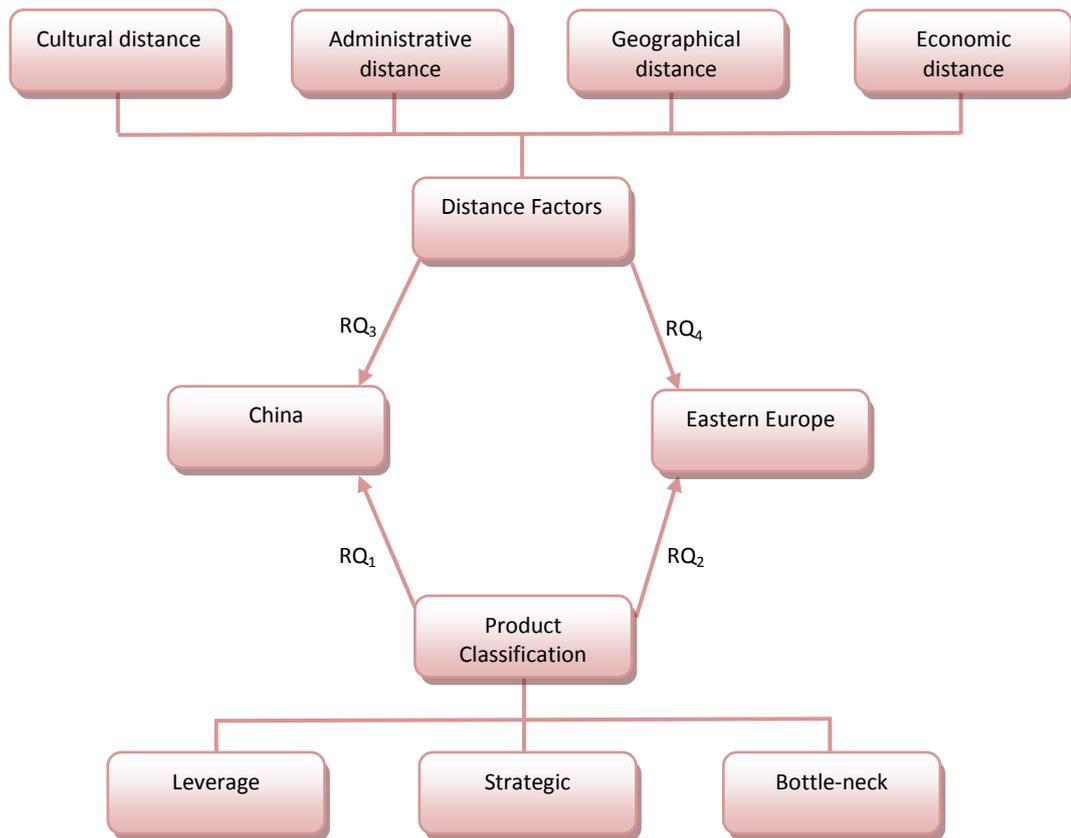


Figure 3.3

Research Model.

## 4 Methods

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*The following section explains the approaches and research methods used to gather the primary data of the study. Selection criteria and chosen study subjects are introduced before describing the data collection and analysis processes in more detail. An evaluation of the reliability, validity and transferability of the study is presented to conclude.*

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### 4.1 Research Approach

A qualitative research approach was chosen to gather the primary data and reach an in-depth understanding and conclusions on the purpose of this research. Qualitative findings enable the researcher to gain various perspectives with knowledge and experience from the interviewees providing more lengthy and descriptive findings than quantitative data would (Patton, 2002). One of the qualitative perspective's strengths in this particular study and in general arises from its capability to establish not only the inputs and outputs of a phenomenon, but also outlines the character of the studied phenomenon (Silverman, 2006) via interrelations of events to consequences (Huberman & Miles, 1994). Qualitative data is based on extensive descriptions and has a high prospective to reveal complex issues (Huberman & Miles, 1994). Additionally, qualitative data allows the maintenance of a chronological flow and increases the likelihood to overcome primary conceptions and extend existing frameworks (Huberman & Miles, 1994). The research is exploratory in nature to gather deeper knowledge of a phenomenon which has not yet been studied in-depth (Goldkuhl, 1998).

To see how specific product characteristics and which different distance factors influence the decision on the location of offshore manufacturing, a deductive approach was used. Deductive approach enables to specify an overall phenomenon (Zikmund, 2000; & Halldórsson, 2002) and analyse theoretical standings in relevance to empirical data portraying reality (Hyde, 2000). Thus, specific product characteristics and distance factors from existing theories on a general phenomenon – outsourcing can be tested to see their application to particular outsourcing locations.

## 4.2 Selection of Case Studies

Since the purpose of the thesis is to analyse how product characteristics and different distance factors influence Swedish companies to outsource manufacturing to Eastern Europe or China, the boundaries of the applicable population were set to Swedish firms. Being a Swedish manufacturer which outsources production processes to both China and Eastern Europe was the first selection criterion. Due to the fact small-and-medium-sized (SME) companies have less resources available to carry out an in-depth analysis on specific offshore locations and are more prone to possible risks of failure, the selected companies had to fall in the SME category (no more than 250 employees). Companies which offshore their manufacturing processes only to enter and serve the foreign market with the new production facilities have different strategies and risks. Therefore, the third criterion of selection was that the firms had to sell the products manufactured at the offshore destination also in Sweden.

A method of simple random sampling was used to choose the respondents, each company that met the sample frame requirements had an equal chance of being selected. To avoid the problem that qualitative samples tend to be non-random but purposive (Kuzel, 1992; Morse, 1989) due to the high possibility of bias in the random sampling when the number of cases studied is small (Huberman & Miles, 1994), a list of all applicable respondents falling within the selection criteria was determined before the actual case selection. The list of companies was gathered via an extensive Internet research in both Swedish and English. Difficulties during the Internet search occurred as companies tend not to be prone of advertising that they outsource their manufacturing abroad, therefore, available offshore job positions of manufacturers were also scrutinized.

As the chosen data gathering method was face-to-face interviews, companies within Southern part of Sweden were chosen in order to limit travel times and expenses. The possible bias of the region is justified by it being a major manufacturing hub of Sweden and hosting a variety of different companies from a multitude of industries. The applicable companies were contacted by phone to make sure they fit the selected criteria; the member of the staff responsible and most knowledgeable of the management of the offshore manufacturing operations was reached before introducing the study and its purpose. While qualitative research tends to entail a smaller sample of respondents due to higher time and labour costs, the data obtained was satisfactory in order to compare the cases and at the same time explore the phenomena on an in-depth level.

The selected respondents during the course of research and interviews decided to remain anonymous. Since the exact names of the companies do not have an impact on the course or result of the research they will be referred to as Company X, Company Y and Company Z.

### **4.3 Interview Guide**

Face-to-face semi-structured interviews were used as a primary data collection method. An interview, first of all, offers a more in-depth overview of the study subject than variable-based correlations of quantitative studies (Silverman, 2006). Data collection via interviews allows flexibility to address additional issues or eliminate unsuitable questions during the data collection process based on the information gathered (Lundahl & Skärvad, 1997). This characteristic is necessary due to the un-standardized nature and characteristics of goods analysed. The choice of face-to-face interviews for data collection was chosen due to this particular method's predicted higher response rates and ease of information obtainment (Williamson, 2002).

When using a semi-structured approach, the question topics and order can be modified to suit the different respondents (Lewis, Saunders & Thornhill, 2009), which permits a more flexible, non-pre-determined responses even further (Lundahl & Skärvad, 1997). This enabled the authors of this paper to use the theoretical framework as a basis for the pre-determined questions as well as asking additional questions based on the various answers obtained throughout the interviews. Mainly “why” and “how” questions were used in order to obtain more elaborate answers. At the same time, researchers must be careful not to lead their respondents with their own perceptions or existing theory of the phenomenon (Silverman, 2006) while using a semi-structured interview.

The full list of interview questions in both English and Swedish can be seen in Appendix 3 and 4. The first section is referring to the purchases from China containing 24 questions. Questions 2-16 relates to the Portfolio Model of Supplier Relationships, and questions 17-24 are relating to the CAGE Distance Framework. The second section is relating to the purchases from Eastern Europe. These follows the same structure as for the purchases from China, i.e. questions 25-40 are related to the Portfolio Model of Supplier Relationships and questions 41-48 relates to the CAGE Distance Framework. The questions are identical for each section and aid to determine as to what type of purchase category the purchase falls into and the dimensions that affects it. Certain dimensions of the Portfolio Model of Supplier Relationships (the Image Factors and Environmental Characteristics) overlap or are linked with the CAGE Distance Framework factors. While the answers to these questions were taken into account during the analysis process when classifying the products, they were discussed in more depth in terms of the latter theory to eliminate repetition. For the distance framework not only the experienced, but also the considered factors were taken into account, as the authors believe it adds to the reasoning behind the decision on a certain outsourcing location. The reason as to why the questions were translated into both English and Swedish was to give the respondents the option to answer them in the language they felt more comfortable to answer in order to gain more in-depth answers. It was also used as an aid for the respondents as a translation guide prior to the interviews.

### **4.4 Data Collection**

To conduct the interview the authors travelled to the headquarters of each of the companies on the dates and times that the respondents chose. This ensured higher participation and decreased any insufficiencies. Before the interviews were started, the respondents were informed of the purpose of the study and how the information gathered from their specific company would be used.

The interview guides were used to form the structure of the interview and cover all required parts of the theory in relation to the purpose however the semi-structured approach

allowed to ask additional questions, examples and clarifications to guarantee no misunderstanding of the terms used. Both authors of the research participated in the interviews held in English to ensure that no areas of interest were forgotten to be covered or any questions on the interview guide skipped, or leading questions to be asked.

A voice recorder was used during the interviews. This allowed the authors to focus entirely on the interviewee, not to stall or disturb the flow of information while taking notes and to capture the answers word-by-word, which was later used to ensure the reliability of the empirical data and to be able to use direct quotes in the empirical data presentation. Follow-up information if required was later gathered via phone calls and e-mails. Also, the interviews were later transcribed.



Figure 4.1

Data Collection.

## 4.5 Analysis Process

A deductive approach of analysis is considered flexible where previous conclusions made are challenged based on new evidence (Benfer, Brent & Furbee, 1991) and begins with theory rather than observation (Thiétart & Wauchope, 2001). Inductive analysis on the other hand seeks to build general themes, categories or patterns from observation (Patton, 2002). This type of analysis has no predetermined categories or codes (Saunders, Lewis & Thornhill, 2009). The categories are developed through observations instead where the researcher finds patterns surrounding the phenomenon (Patton, 2002). Patton (2002) argues that the degree of inductive or deductive approach varies along a continuum, and that this may change along the process. We chose a more deductive approach to our research where predetermined categories were found through literature review. Common themes were found through this process and found suitable for answering the purpose. Saunders et al. (2009) explains the complex nature of qualitative analysis through different dimensions (see Figure 4.2).

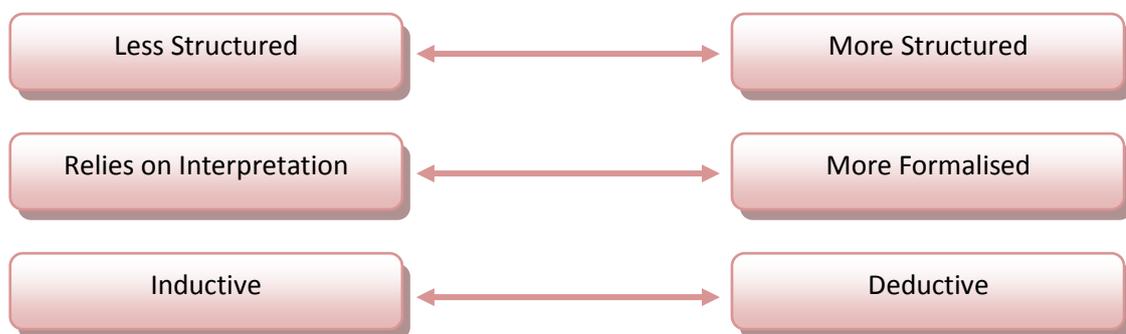


Figure 4.2

Dimensions of Qualitative Analysis (Saunders et al, 2009, p.491).

Some procedures may be more structured than other procedures, more formalised data is relating to categorisation, and structuring meanings through narrative is connected to relying on interpretation of the researcher.

Saunders, Lewis and Thornhill (2009) have identified three types of processes for grouping the data obtained through qualitative methods; summarising of meanings, structuring of meanings using narrative, and categorisation of meanings. These processes can be used separately or combined depending on the data. Summarising data means that the researcher takes the large amount of data obtained and condenses this data into smaller amount of words containing key words. The researcher will then identify certain themes from the interview which can then be used for the following interviews. Relationships between the themes may also be found which can be written down. Structuring data using narrative is relating to “individuals’ accounts of their experiences and the ways in which they explain these through their subjective interpretations and relate them to constructions of the social world in which they live” (Saunders et al., 2009, p. 497). Developing categories and attaching these categories to meaningful pieces of data are the two steps involved in categorising data. This method will allow the researcher to identify relationships and develop the categories he or she has chosen to use for the paper. The categories can be determined from the theoretical framework of the research, which will translate into the labels or codes for the data analysis. By using categories, new insights can be obtained for each category that can lead to the identification of new ones.

For the purpose of this study, the authors have chosen categorisation of data by using the theoretical framework and its components as the codes for analysing the data. Once the empirical findings were matched with the categories, the analysis took place where the data from the different interviews were compared and conclusions were made as a result.

## **4.6 Evaluation**

### **4.6.1 Reliability**

The conclusions of the research process must be error-less, reproducible and consistent over time to ensure reliability (Zikmund, 2000; McBurney & White, 2007) which is influenced by participation error, participant bias, observer error, and observer bias (Lewis et.al, 2009).

Respondents giving uncharacteristic answers after being put in anomalous situation create participation errors (Lewis et.al, 2009). To ensure reliability on this level the overall subject of the interview was explained beforehand to ensure that the respondent would be knowledgeable and prepared to discuss the subject in detail. In addition, the participation was completely voluntary and designed to fit the time and place for an interview to suit the respondent’s preferences. It must be noted that most of the interviews were held in English, the usage of the respondents’ non-native language might have resulted in confusion and possible misinterpretation of questions. This problem was limited as the authors/interviewers have a native Swedish speaker among them to explain and translate if necessary. Also, an interview guide in Swedish was provided to all respondents.

Participant bias occurs when respondents intentionally answer dishonestly (Lewis et.al, 2009), therefore, all respondents were given a choice to remain anonymous to decrease this issue of reliability. Nevertheless the authors cannot ensure that certain information was not exaggerated or withheld to favour the image of the company.

To eliminate observer error and the observer bias, an intentional distortion of the results to fit the purpose (Lewis et.al, 2009) the empirical data was transcribed and continuously assessed throughout the analysis process, and the data was sent to the interviewees before publishing to avoid misinterpretation or distortion.

#### 4.6.2 Validity

The ability of a measuring instrument to test what it is intended to test is referred to as validity (Lewis et.al, 2009; Zikmund, 2000). Validity of the research is ensured by using a simple random sampling method to collect primary data. However, there is an existent possibility that only companies with successful near-sourced manufacturing operations in Eastern Europe agreed to participate in the research.

#### 4.6.3 Credibility

Theoretical framework and the bases for research method have been based on materials published in peer reviewed journals, industry reports and books to increase the data credibility. The authors have kept in mind the continuously changing and developing stage of near-sourcing, and strived to overview the most up-to-date findings and publications and include them in the report together with widely accepted academic work in the field of study as well as real life examples.

## 5 Empirical Data

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*An introduction of a company is given before presenting the respective product characteristics and distance factors when sourcing in China and Eastern Europe case by case. A visual summary of the data between the different cases concludes this part of the thesis.*

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Only a short overview of the selected case study companies is presented in this section as more detailed presentation does not affect either the research process or results. For more in-depth company profiles see Appendix 5.

### 5.1 Company X



Figure 5.1

Company X Overview.

## **5.1.1 Case of China**

### **5.1.1.1 Outsourced Products and Local Supply Market**

Since mainly standardized components and finished products are manufactured in China, their end-value per piece is relatively low or indifferent from products manufactured elsewhere. Therefore, according to the purchasing manager of the company, the outsourced processes and items are not considered as core competencies. Customization and manufacturing of new to the market products is possible, however, the majority of production consists of standard high-volume goods; therefore, no specific investments in innovative technology or skills are required. The high volumes of production however increase the importance of logistics and require the company to hold safety stocks.

Even though the current suppliers in China employ tens of thousands of workers and supply to other companies within the Group, the respondent was convinced they would be easy to substitute if required. The purchasing manager estimates that there are many suppliers in the region which would at least partially meet the requirements of the company in case of a supply chain disruption from its current suppliers. More specific analysis however has not been carried out and as the purchasing director explained it *“you cannot have a back-up plan for everything”*. The relationships are mainly based on a signed contract on commercial terms between the buyer and supplier.

### **5.1.1.2 Encountered and Considered Distance Factors**

The purchasing director confirms that the management is aware of the possibilities of cultural differences with their Chinese suppliers, but cannot recall an example when it has occurred in the past so he therefore does not think it has affected their relationship. The lack of knowledge and ability of written and spoken English however is pointed out and seen as a barrier when dealing with the suppliers in China. - *“You have to be extra clear and get a confirmation that what you have said is understood”*.

Company X has not encountered any political or legal constraints during its partnership with Chinese suppliers and mainly uses its own sourcing team located in China to find and choose its suppliers. Possibilities of unfavourable currency rate changes though are named as a factor that could influence the future outsourcing in China. It is added by the respondent that *“anything that affects costs or jeopardizes the supplies would be a determinant whenever we source, not only in China”*. The purchasing director said he was not aware that the company had ever been exposed to any problems of IPR infringement. More so, *“a new supplier has to pass our audits and fulfil our requirements including our Code of Conduct”* thus the company would insure its reputation and standards. If the supplier does not meet the requirements or does not agree to fulfil them, a contract is not signed. New suppliers in China are used for limited business and the company tries to have a dual source if possible during the trial period of the new supplier.

The purchasing director admits that the long geographical distance necessitates them to have on-site personnel of their own to meet the shareholders expectations. The relationships with the external suppliers are therefore also more of an arms-length type as it is time consuming and expensive to travel to the site from the headquarters. It is noted that while the main benefit of China is lower prices, there is a considerable disadvantage of *“the costs of shipping, warehousing and communication”*. The long physical distance of manufacturing in China requires the company to keep buffer stocks due to the long lead times, to guard themselves against disruptions and stock-outs, and perform a quality inspection on all the items before shipping.

The technical capabilities of the Chinese suppliers are evaluated as satisfactory for the requirements of the company. *"In spectrum of China"* – the respondent added. The availability and cost of labour which relates to the most of the savings was named as one of the main reasons why China was chosen as an attractive sourcing location. As soon as a product, which might have been produced somewhere else before, reaches a certain volume the production is transferred to China to exploit the cost savings.

## **5.1.2 Case of Eastern Europe**

### **5.1.2.1 Outsourced Products and Local Supply Market**

Only a variety of standardized, proven and well established components are outsourced to manufacture in Eastern Europe, however, even if the end-value per piece is not large or considered be core competencies of the company they are important for the final product and sustainable production of finalized goods. The type of goods manufactured also explains why no special investment in technology or training is required from the company.

About 35000 workers are employed by the suppliers in EE. The purchasing manager, just as in case of China, points out that there would be no problem to find substitute suppliers in the region if needed as nearly all suppliers could meet their requirements. Still, no specific analysis has been carried out on this issue. The relationship with the suppliers in EE is also based on the contract that sets commercial terms between the buyer and supplier.

### **5.1.2.2 Encountered and Considered Distance Factors**

The purchasing director does not think that major or noticeable cultural differences exist between the company and its EE suppliers, as it has never impacted the business relationships. When asked about language barriers he says that the knowledge of English is better in Eastern Europe than in China, therefore, communication with the EE suppliers is easier.

No political or legal issues, problems meeting safety or environmental standards, IPR infringement problems, or reputation damages based on sourcing in Eastern Europe could be recalled. The supplier selection process is the same as in China – the supplier must meet and fulfil the Code of Conduct of the company before the deal is signed.

Physical distance between Sweden and sourcing locations in EE are said to have no effect on the business relationships. While the shorter distances allow more constant communication due to no significant differences in time zones, the company still must keep buffer stocks to ensure the sustainability of its business.

The technological capabilities and labour skills of its EE suppliers are evaluated as satisfying. While lower prices/costs in EE are seen as the main advantage for outsourcing in the region at the moment, there are significant cost differences among the EE countries. The TLC between manufacturing in China and EE varies from 0% to 15-20% depending on specific EE country. He confirms that China still does have an advantage of lower labour costs, but adds that it is 'eaten up' by the costs of logistics and customs. The respondent agrees that manufacturers will eventually move their production activities to nearer locations – *"we will increase our efforts in order to find sources in Eastern Europe. The simple explanation why is the total cost including need of bigger buffer stock for flexibility as an alternative to the Chinese"*. An important factor for future relationships with the suppliers of the region will be the general stability of Eurozone.

## 5.2 Company Y

**Founded:** 1940s      **Industry:** designer and manufacturer of furniture  
**Nr. of Employees:** 95      **Certificates:** ISO 14001 and ISO 9001  
**China:** production of standardized high-volume components  
**Eastern Europe:** production of customized process of quilting

Figure 5.2

Company Y Overview.

### 5.2.1 Case of China

#### 5.2.1.1 Outsourced Products and Local Supply Market

Even though only components in high volumes are produced in China and the final assembly is kept in-house, and the end-value of the outsourced manufacturing per piece is low, they are necessary for added-value on the finalized product. As only components are manufactured in China, they are not considered as core competencies of the company. The majority of processes are done manually allowing producing also customized parts. Certain components require two hours of manual work per piece, and as labour costs in Sweden are high for such work, customization in-house is too expensive. The high volume manufacturing in China requires the company to keep buffer stocks.

The biggest supplier in China employs about 200 workers and all of the suppliers work with other companies as well. Due to its high emphasis on quality, Company Y has invested heavily in both technology and staffs training to make sure its standards are met. Even though the firm invests significantly in the capabilities of its suppliers in China, the technology or training is nothing too innovative for the industry in general. The firm strives to have long-term relationships and reduce the number of suppliers to have a better control over quality and higher levels of reliability. This has led to closer and also more dependent relationships as very few substitute suppliers could be found in the region without new investment. This has led to new designed components together with the suppliers to make sure that the available technology will be suitable.

#### 5.2.1.2 Encountered and Considered Distance Factors

The sourcing developer who is responsible for the management of the supplier relationships in China has lived and worked there himself, and speaks some Chinese which helps him to overcome cultural and language barriers in the relationship. However, he is not sure how the management dealt with the issues before as there still are certain language barriers.

Company Y has not encountered any legal or political issues in China and is not afraid of IPR infringement risks, as the suppliers are only capable to produce components and not entire products. Furthermore, the local government is trying to make the Chinese market and policies more applicable to Western standards. However, the respondent was concerned about the undervaluation of Chinese Yuan as it increases the costs of manufacturing in China every year.

Additional effort has been required to meet safety standards. *“We try to teach safety standards to suppliers as much as possible...and try to make them understand that people are important”* says the sourcing developer. The workers themselves are not making the process easier. One example is where the management of Company Y had explained the danger of becoming deaf if

headphones will not be worn when working next to the loud production machines. Returning to the site a couple of hours later all of the headphones had been taken off because they were not comfortable. Due to this gap of standards the company itself has taken under control the measurements of everything hazardous in the production process, and special controllers on the site are hired to manage the compliance and remain its high reputation.

The travel distance limits direct communication and control and the reliability of the local management is therefore crucial. As Company Y stresses its high quality, the company has both Swedish and Chinese quality controllers in China to limit extra costs if the items do not meet the requirements and must be shipped back. Freight damages still occur, and to safeguard itself the company has decided to keep bigger amount of stocks to ensure smooth production for a period of half a year. *“China is still cheaper but not as cheap as it used to be”* the sourcing developer says, as the handling and shipping costs have increased significantly since the company started outsourcing in China. This is one of the reasons why only high-volume items are sourced, and the company is planning to decrease the frequency of shipments from twice a month to a full-load only freight once every two months.

Even though the company invests in the labour and knowledge resources in China, it still has a trial period for new suppliers to make sure that they are reliable. While there is an extensive supply of labour available, their training takes a lot of time and investment. The Chinese labour however allows the company to produce more customized components for a reasonable price as they need to be handcrafted. New designs are also cheaper to test in China than in Sweden.

## **5.2.2 Case of Eastern Europe**

### **5.2.2.1 Outsourced Products and Local Supply Market**

While the end-value of the manufacturing process of quilting sourced in Poland is not very high per piece, the process itself is innovative and products highly customized. The process requires special training and experience, and the supplier in Poland is the only one in Europe that can execute it. The supplier is a large international company working with many large furniture manufacturers. Additionally, there is only two workers in the factory who is skilled enough to customize the parts according to requirements.

### **5.2.2.2 Encountered and Considered Distance Factors**

The contact person of the Polish supplier is Danish, which has led to non-existent language barriers as both parties speak English. The other staff members on the other hand do not share the same level of skills, and Company Y has encountered certain misunderstandings both due to language problems and a very straight forward expression of their thoughts.

The company has not encountered any legal or political barriers during its partnership with the Polish supplier. Additionally, all safety and environmental standards were already in place before the signing of the contract, hence, it has eliminated the need to investments in assuring compliance. However, the company is cautious about the possible corruption levels in Eastern Europe, especially the non-EU countries.

Communication and management are easier to achieve with the Polish supplier due to shorter geographical distance. The supplier is also able to deliver the items within 3-5 days creating significantly shorter lead-times.

The competence of the supplier is evaluated as high when many other companies use it as it serves as a reference during the decision process. While a certain level of the finished components gets damaged during the production process, Company Y is more lenient as the supplier is currently undergoing a trial period. Additionally, the supplier covers the costs for re-manufacturing if required. The respondent states that Eastern European countries do have a price advantage in comparison to manufacturing in Sweden and offer higher level of flexibility than production in China. It is pointed out that it would be very expensive and time consuming to move the manufacturing to EE and build new network of reliable suppliers to meet their specific requirements, due to the high investments which have been made in the Chinese suppliers. On the contrary, changes in the future might be possible – *“Looking at the development of China – it will get expensive and in 5-10 years time we might out-source the manufacturing of high-volume goods to Eastern Europe”*.

### 5.3 Company Z



Figure 5.3

Company Y Overview.

#### 5.3.1 Case of China

##### 5.3.1.1 Outsourced Products and Local Supply Market

Finished products that each are unique and highly customized are manufactured in China, and the respondent stated that these items have no impact on the core competencies of the company. The firm specialises in the planning, development and calculates the tender of the item, and then manufacturing takes place. Additionally, Company Z does not themselves invest in machinery and initial training for the production in China.

Currently, about 15 suppliers are used in China to ensure the production and their size varies greatly between 15 to a couple of thousands of employees. The respondent was sure that quite a few local suppliers were able to meet their requirements if a substitute was needed. Company Z strives to have close relationships with its Chinese suppliers. Many visits are made to exchange experiences, monitor production and give instructions to the staff.

##### 5.3.1.2 Encountered and Considered Distance Factors

According to the respondent, the language barrier has been and still is a major issue for the company when manufacturing in China. It is something that has required a lot of time and effort from the company to deal with. He says that very few people in China can speak and understand English and they are mostly the young generation, who has little knowledge of technology concerning the products. Everything must be translated and only then passed on to the more knowledgeable staff members, which often leads to misunderstandings. The respondent points out that one of the biggest cultural differences between Sweden and China is that Chinese people are used to take orders and not question anything regarding the instructions. While it is said as only a generalization, he believes that people in China

are not encouraged to think freely, do not question things they do not understand, and do not take initiatives to make their own decisions.

No political, legal or IPR risks have been encountered while manufacturing in China. Even though the company has never encountered any issues about safety standards while manufacturing in China, it has been required to put an effort into assuring it. Clear instructions have been given in order to assure that the staff in China would know what norms must be followed. To make sure the requirements are implemented, a test sample and documentation is produced and presented to the perspective customer for approval before production takes place. Since the products themselves have a very little impact on the environment the environmental goals are easily met by the Chinese suppliers.

The long physical distance between the buyer company and its Chinese suppliers has had a great impact on the inventory strategy of Company Z. It has tied up a lot more inventory space and requires orders containing much bigger batches than it would if the production was in-house. If a customer wants to make changes to the product characteristics it takes a lot longer to put these changes into action as the long distance requires an 18 week planning in advance, and previous batches need to be used and consumed first. On the other hand, time zone differences are seen as a minor issue as e-mails allow a timely communication. Additionally, the Chinese suppliers are very polite and respond very quickly.

The cheap labour is named as a major factor for manufacturing in China, although the prices are rising drastically. Materials also tend to be cheaper at times, although the prices of raw material such as copper is almost same everywhere. The respondent says that the company is content with the technological and labour skills of Chinese suppliers, but wishes it was a lot better. The company has also encountered problems with their Chinese suppliers in terms of capacity, as there has been a shortage of workers up to 20-30 percent on a couple of occasions in the last one and a half years, which has caused delays. The respondent continuously stresses that it would have been preferred if the production was held in-house only. It would provide a more secure production, control and overview of the entire supply chain, and have a higher educated staff which would be more prone to take its own initiatives. Additionally, the payment conditions in China require Company Z to pre-pay thus significantly impacting availability of free resources.

### **5.3.2 Case of Eastern Europe**

#### **5.3.2.1 Outsourced Products and Local Supply Market**

Just as in the case of China, highly customized and unique finished items are produced also in Poland, and do not have an impact on the core competencies of the firm for the same reasons as mentioned before. The biggest difference arises from the fact that Company Z has invested in the machinery, materials and training of the Polish staff and plans to continue to do so in the future.

There are currently six or seven people working at the plant and has Company Z as their only customer. This has led to a very close relationship between Company Z and the supplier. The respondent is certain that a lot of suppliers in Poland can meet the requirements of the firm.

#### **5.3.2.2 Encountered and Considered Distance Factors**

The interviewee does not think there are any cultural differences between the Swedish and Polish workers. The mind-set is told to be very similar and the employees in Poland think freely and make decisions based on their own judgement. No language barrier has been ex-

perienced as the staff speaks English. Additionally, certain members speak Swedish which eases the communication even more.

No political, legal or IPR risks have been encountered. Since Company Z has been highly involved in the development of the factory in Poland, all safety and environmental standards are met. The plant also has test equipment which allows producing the required samples.

The closer geographical distance allows the products to be sent once a week and requires only approximately two visits to the site per year. Consequently, this entails a lot less time and effort for management in comparison to China. The distance also allows the Polish staff to visit the factory of Company Z in Sweden to gain new experience and training. Due to the small geographical distance from Sweden the production in Poland has had a very little and marginal impact on the inventory strategy of Company Z. Smaller volumes and shipments can be implied which allows the company to order only 14 days in advance and reduces the amount of money that is tied to inventory.

The respondent says that the company is very satisfied with the technology and labour skills of the Polish partner, and the production there is not very different from the factory in Sweden. While the labour costs are higher than in China, they are still lower than in Sweden and the staff requires less attention and control. In addition, payment conditions in Poland are a lot better than in China. Company Z is considering opening new production facilities in Eastern Europe with Hungary as a first location in mind as the EE countries which are members of EU make trade easier.

## 5.4 Summary of Empirical Data

Table 5.1

Summary of Empirical Data.

	Company X		Company Y		Company Z	
	Country: China	Country: Poland Slovakia Estonia	Country: China	Country: Poland	Country: China	Country: Poland
<b>Classification of Products Outsourced</b>	Leverage	Leverage	Leverage	Strategic	Leverage	Leverage /Strategic
<b>Cultural Distance</b>	+ no impact of cultural differences	+ no impact of cultural differences +English skills	+ Swedish management has knowledge of cultural differences and language	+ international management to ensure language skills	+ not mentioned	+ no impact of cultural differences +English skills
	- English skills	- not mentioned	- English skills	- English skills of staff -very straight forward expression	- English skills - collectivism	- not mentioned
<b>Administrative Distance</b>	+ no political or legal barriers	+ no political or legal barriers	+ no political or legal barriers	+ no political or legal barriers	+ no political or legal barriers	+ no political or legal barriers
	+ no IPR infringement issues	+ no IPR infringement issues	+ Chinese government supports FDI	+ no IPR infringement issues	+ no IPR infringement issues	+ no IPR infringement issues

	+safety and environmental standards met	+ safety and environmental standards met	+ no IPR infringement issues	+ safety and environmental standards met	+environmental standards met	+ safety and environmental standards met
	- currency risks	- not mentioned	- undervaluation of Chinese yuan - need to invest to meet safety goals and environmental standards	- fear of corruption (especially in non-EU countries)	- need to put effort into safety standards	- not mentioned
<b>Geographical Distance</b>	+ not mentioned	+ no effect on relationships + no significant difference in time zones + more frequent communication possible	+ not mentioned	+ easier communication and management + short lead-times + increased flexibility	+ not mentioned	+ higher degree of control + no buffer stocks

	<ul style="list-style-type: none"> <li>- on-site personnel required for control</li> <li>- arms-length relationship</li> <li>- additional warehousing, communication and shipping costs</li> </ul>	- buffer stocks	<ul style="list-style-type: none"> <li>- limited direct communication</li> <li>- decreased control (need for on-site quality control)</li> <li>+ buffer stocks</li> <li>+ shipping costs</li> </ul>	- not mentioned	<ul style="list-style-type: none"> <li>- buffer stocks</li> <li>- slower implementation of changes</li> </ul>	- not mentioned
<b>Economic Distance</b>	<ul style="list-style-type: none"> <li>+ cheap labour</li> <li>+ skills and knowledge</li> </ul>	<ul style="list-style-type: none"> <li>+ cheap labour</li> <li>+ skills and knowledge</li> </ul>	<ul style="list-style-type: none"> <li>+ cheap labour for manual work</li> <li>+ cheap environment for testing designs</li> </ul>	<ul style="list-style-type: none"> <li>+ labour skills and knowledge</li> <li>+ supplier cover damage costs</li> </ul>	<ul style="list-style-type: none"> <li>+ cheap labour</li> <li>+cheap materials</li> <li>+skills and knowledge</li> </ul>	<ul style="list-style-type: none"> <li>+ cheap labour</li> <li>+ skills and knowledge</li> <li>+ quality of production</li> <li>+ payment conditions</li> <li>+ EU membership</li> </ul>
	- not mentioned	- Euro-zone instability	- unreliability of quality	- damage rates during trial period	<ul style="list-style-type: none"> <li>- shortages of labour</li> <li>- payment conditions</li> </ul>	- not mentioned

## 6 Analysis and Discussion

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*The next section presents the analysis and discussion of the empirical data of all case studies combined answering each research question turn by turn before comparing the cases of China and Eastern Europe.*

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### 6.1 Characteristics of Products Outsourced to China

*RQ<sub>1</sub>: How are the different product characteristics related to the decision to outsource to China?*

The answers of the respondents when analysed in terms of the dimensions of the Portfolio Model of Supplier relationships (see section 3.2.3.1) show that there is an absolute consensus of the type of goods outsourced to China – leverage items. This conclusion is drawn based on the following reasoning.

On the Step 1 of the Portfolio Model of Supplier Relationships the items must be weighted on the scale of Strategic Importance of the Purchase (Olsen & Ellram, 1997). All of the respondents stated that the products outsourced to China were not the core competencies of their companies. This is one of the Competence Factors that classify the Strategic Importance of the Purchase (see Appendix 1) which in this case is therefore low/medium (Fiocca, 1982). Based on the answers that the studied companies required their Chinese suppliers to either invest in their production capabilities themselves, or had to invest in technology and labour skills to meet the requirements and standards of the buyer company, it can be seen that the interdependence between the buyer and supplier varies between medium and low. Even though high-volume, low-value, non-complex and standardized goods and components build up the majority of production (with the exception of Company Z) their availability and fit to the requirements of the buyer company show a medium/high importance of the purchase. In case of Company Z, the interdependence between available and required know-how for the highly customized items is obvious. All the investment in specific technology and know-how to fulfil these company-specific standards increase the level of the strategic importance of the supplier (Reve, 1990) and a disruption or delay on production would damage the entire supply chain. The Economic Factors of the outsourced goods also lay on a rather medium/high level. Even though the end-value of each piece/component is considered by the buyer company as low – the total monetary value of the purchase is high and important. Price and cost savings were mentioned as the main factors for sourcing in China thus a low-cost supplier is beneficial (Kraljic, 1983). Production of scale and high-volumes is implemented in China to exploit the ability to leverage with the suppliers (Fiocca, 1982). The average weight of the Strategic Importance of the Purchase is medium/high.

Step 2 weights the Difficulty of Managing the Purchase (Olsen & Ellram, 1997). Even though a certain level of customization is possible and done at the manufacturing facilities in China, two of the respondents stated that the majority of the production is standardized. Company Z produces only customized products and the respondent stated that the items manufactured in China are not more complex than the ones produced elsewhere. This fact presents a low/medium level of Difficulty of Managing the Purchase (Fiocca, 1982; Homse, 1981) as the complexity and novelty is relatively low in terms of Product Characteristics (Appendix 2). The Supply Market Characteristics are also on a medium/low scale as while the Chinese suppliers are rather large in terms of employees and have other partners they could be substituted if necessary as pointed out by two of the respondents, thus the power advantage is still higher for the buyer company (Kraljic, 1983; van Weele, 2000;

Arabzad & Ghorbani, 2011). In case of Company Y, the respondent stated that due to the large-scale investments over the years in development and training the staff of its Chinese suppliers, it was doubted a substitute supplier could be easily found. Nevertheless, these investments were made to ensure the reliability of the supplier and were not too innovative to the industry. Since the Chinese suppliers differ significantly from one another in terms of their reliability, quality and speed (Murphy, 2004), it is not surprising that the required investment from the buyer company in technology and labour skills also differs depending on the specific selected supplier. The fact that all of the studied companies source from more than one Chinese supplier increases their power advantage even further as the supplier base is scattered (Kraljic, 1983), which again increases the availability (Kraljic, 1983) and ability to bargain for lower cost (van Weele, 2000). The average weight of the Difficulty of Managing the Purchase is thus low/medium.

This strategy confirms and follows the theory of Portfolio Model of Supplier Relationships, which advocates that international sourcing is the most suitable for the goods which have a medium/high strategic importance of the purchase and low/medium supply risk (Kamann & Van Nieulande, 2010). All of the companies, while striving for a long-term relationship to ensure the reliability of their Chinese suppliers, have more of an arms-length relationship with them due to the physical distances and standardized purchasing processes. This observation follows the advised procurement strategy of leverage items that no investment should be made in the specific relationship (Kraljic, 1983). The leverage items have a great impact on the financial results of the company (Gelderman & van Weele, 2002; Kraljic, 1983), thus the exploitation of the cheap and available Chinese labour is the major driver when deciding upon the sourcing location.

## **6.2 Characteristics of Products Outsourced to Eastern Europe**

*RQ<sub>2</sub>: How are the different product characteristics related to the decision to outsource to Eastern Europe?*

The classification of the items manufactured in Eastern Europe from the studied companies varies between leverage and strategic goods. Accordingly, Step 1: the Strategic Importance of the Purchase, remains on a medium/high level for all of the companies. The reasoning behind this classification and specific characteristics follow the same reasoning as explained in the previous section 6.1 with the exception of Company Y. The Eastern European supplier of Company Y is the only available supplier thus the dependency of the firm is high instead of low.

The changes between the classification quadrants lay on the Step 2 of the Portfolio Model of Supplier Relationships. The level of Difficulty of Managing the Purchase varies all along the scale. The factors that influence this change are: high technological competence of the supplier (Companies X and Z), high supplier power and low possibilities for substitutes (Company X), and the novelty of the item (Company X). Even though no clear-cut answer can be drawn of one certain type of goods that are manufactured in Eastern Europe it can be concluded that: these items have a medium/high Strategic Importance of the Purchase and their Difficulty of Managing the Purchase depends on each specific case.

The collected data supports the theory that strategic items should be sourced from a small number of suppliers, preferably one (Kraljic, 1983) – both of the companies whose outsourced products lie within or on the border of the strategic quadrant have only one supplier in EE. The results of the data of companies which manufacture strategic products in Eastern Europe contradict with one another on this issue. If the supplier of a strategic product has the power dominance, the buyer firm should look for substitute suppliers or

goods (Kraljic, 1983). This explains why Company X plans to bring the production back in-house, which would also ensure the long-term availability of the product (Kraljic, 1983) and the reason as to why they selected the supplier based on references to ensure the crucial reliability (Kamann & Van Nieulande, 2010). In cases when the buyer has the power advantage, minimal supply chain risks and costs can be exploited by the buyer company (Kraljic, 1983). The high investments and knowledge sharing in the development of its EE supplier by Company Z present this strategy.

Interestingly, the two smaller companies from the selected cases are the ones which source strategic products from Eastern Europe. By theory, strategic items are not advised to be sourced from low-cost countries to ensure the reliability on items with high profit impact and difficulty to manage (Kamann & Van Nieulande, 2010). This presents why the buyer company either plans to in-source the production or develops the supplier itself to avoid the possible pitfalls. Another explanation why exactly the smaller companies are daring enough to outsource strategic goods can be based on the assumption that they are more entrepreneurial and less bureaucratic to adopt new strategies since their capability to invest highly in in-house technology might be low. In contradiction, smaller firms are also more prone to higher risks and supply chain disruption due to less back-up resources if problems arise.

The difference of the types of outsourced items (leverage and strategic) also differs depending on the specific EE country. Some countries are more developed and have more skilled labour and higher labour rates while some offer lower labour rates but also a lower capability of technological skills and knowledge. The industry and product specification must also be taken into account.

The changing consumer demands are predicted to force the companies to employ make-to-order strategy instead of the current make-to-stock (Jacoby & Figueiredo, 2008). Shorter distances allow efficient exploitation of shipments of smaller volumes than in case of China, which in turn increases the structural flexibility of the buyer company. Therefore, the structural flexibility, which is crucial to remain competitive, can be achieved via shorter physical distances (Martin & Holweg, 2011).

### **6.3 China-Specific Distance Factors and Their Impact**

*RQ1: What is the impact of the cultural, administrative/political, geographical and economic factors specific to China that would determine whether a company should start, continue or discontinue outsourcing manufacturing in the country?*

#### **6.3.1 Cultural Distance**

Surprisingly, even though cultural differences in general have been proposed as the dominant barrier of successful off-shoring (Wendell, 2009), respondents had contradicting experiences about it. All of the interviewees agreed that they were aware of the possible dissimilarities between their and the Chinese culture before the contracts were signed and they still are. However, in opinion of two of the respondents, it has never had a direct effect on the buyer-supplier relationship. In contradiction, the burden of the collectivism brought forward by Hofstede (1980) had been a continuous issue for one of the companies. The respondent Company Z stressed the different business ethics and working styles of Chinese, also mentioned by McGregor (2005). The fact that the respondents are conscious of the intangible factors of external relationships, in comparison to the old-school with purely financial bottom line focus, presents the “new school” of management and buyer-supplier

relationship (Kathawala, Zhang & Shao, 2005). Nevertheless, culture is a vague and hard to classify factor (Wendell, 2009) and the managers of the buying companies might not be fully aware of its impact on the relationship and sourcing process. Cultural differences and social norms are hard to notice (Hofstede, 1980), especially when not being on-site to deal with it on a daily basis or having a direct communication and contact. The long-term orientation has been noted as one of the social norms for Asian cultures (Hofstede, 1980; Ross, 1999). Therefore, the fact that the buying companies must invest time and effort in the relationship, not only because of the language barrier, but to also create trust and reliability, is in a way an indirect indicator of the existent cultural differences. Additionally, the unawareness of issues created due to cultural differences might relay on the fact that Chinese upper and middle managers are reluctant to express their actual opinion and talk openly of existent problems (McGregor, 2005) to avoid conflicts and pressure (Hofstede, 1980).

Each of the respondents has a different management approach of their Chinese suppliers – Company X uses its own culturally mixed sourcing team, and a local management is used by Company Y and Z to run the factory. This strategy of having a cross-cultural team, which has knowledge of and/or experience with the specific culture, as an enabler of more successful cross-border relationship is supported both by the interviewees and theory (Wendell, 2009). This importance is even further stressed by the admission that spoken, and sometimes also written, knowledge of English is indeed common and problematic. To avoid misunderstandings, it was understood from the respondents' experiences, that an additional effort is required of the Swedish companies to either hire a local middle-man for translation or forces to invest extra time to administrate these relationships if the company does not have a member of staff which speaks both languages. This investment in specific relationships which deal with leverage items does not allow the buyer company to fully exploit the possible benefits in the most effective way (Kraljic, 1983). On the contrary however, the interviewees did not confirm the rareness and difficulty to find skilled Chinese management as it has been mentioned by Wendell (2009).

### **6.3.2 Administrative/Political Distance**

Since none of the respondents had ever encountered any political, bureaucratic or legal constraints during their operations in China the authors are possible to draw the following conclusions. The Chinese government is indeed working on easing the business activities of foreign companies within the country to support the growth and flow of FDI (Furniss, 2003) by liberalizing its previous policies (Alon et.al, 2007). In contradiction, higher levels of corruption/bribery might be evident among the activities between national businesses and government, but not with foreign companies, to ensure the image of the “Westernization” of the country. The fact that the interviewed companies use either their own sourcing teams or local agents to manage the business operations might be another reason why the managers in Sweden have not been faced with the political or legal issues of starting and running a business in China, as they do not have a direct contact with the Chinese government officials. Based on the characteristics of Scandinavian management Swedish management has higher requirements on transparency and appliance of laws and standards (Sjøborg, 1985; Railo, 1988). This might mean that the best-off class suppliers, like one of the respondents described its selection of a supplier, are selected and the data of these cases do not always represent the actual situation. This is presented by the fact that the studied companies have a trial period of each new supplier.

In contrast to the data of high IPR infringement and piracy risks (Sang-Eun, 2008), none of the respondents agreed that these issues had ever been a problem for them. Firstly, this can be explained by the characteristics of the items chosen to be manufactured in China (see

section 6.1 for more details) and the industry the company is working in. Production of components only, owning the factory or having highly customized and unique products decreases the risk of IPR infringement. The local companies have limited knowledge how exactly the parts are used on the final product, higher levels of control are achieved when the factory is under direct and internal control of the buyer company and piracy of a product which is never the same as before, limits the possibilities of copying it. It must also be noted that Western agencies and media may exaggerate the levels of the IPR infringement risks as part of the increased trend to bring production back home due to the recent economic recession (Kathawala, Zhang & Shao, 2005).

While all of the respondents ensured that their standards on labour rights and safety and environmental goals are met in China, certain differentiation in answers is visible. The proposition put forward by Eisenhardt (2002) that low-cost countries lack behind the developed world on terms of safety, environmental and labour safety standards, has been partially confirmed. Largest of the companies, Company X, obliges its suppliers to meet the requirements on their own and sign its Code of Conduct. When this non-investment strategy is used by a small company (Company Y), the standards tend to remain purely written and not implemented. McGregor (2005) has also brought up this issue when written contracts in China hold no significant importance. Two of the smallest interviewed companies, which either did or did not invest in the education of the standards, admitted that a continuous external control was still required to ensure the application of the standards, especially by the factory-floor personnel. This observation can be traced back to the differences on work ethics (McGregor, 2005; Hofstede, 1983) that the companies themselves do not see as a cultural difference. Since the buyer companies use Swedish or mixed teams of on-site controllers, certain issues with trust in the local management or already mentioned work ethics are evident. The added costs for employing these people can be seen as a type of required investment even if the studied companies did not see it in this way themselves. Lastly, the unpredictability of the undervaluation of the Chinese Yuan was a commonly mentioned concern for future sourcing in China. The unfavourable exchange rates thus do harm the foreign buyers via higher prices (Aggarwal and Soenen, 1989).

### **6.3.3 Geographical Distance**

No advantages of having a longer physical distance between the site of production and point of consumption have been mentioned which most visibly presents the disadvantages or shortcomings of far-shore manufacturing. Long lead times which are seen as the most underrated issue of geographical distance (Kumar & Eickhoff, 2005; Das & Handfield, 1997) have indeed affect the inventory strategies of all interviewed companies by increasing their warehousing costs significantly. Buffer stocks for periods up to half a year were mentioned to ensure the companies from disruption of the supply chain, an issue also pointed out by Fredriksson & Jonsson (2009). Increasing shipping costs and possible damages due to long travel distances is another concern (Ferreira & Prokopets, 2009). The shipping costs have forced the interviewed companies to use batch orders to remain efficient, which increases the mentioned inventory levels. The possible damages during shipment add to handling costs and the necessity for on-site quality control, and even then creates a freight rate uncertainty (Leach, 2012; Ferreira & Prokopets, 2009). All of these issues mentioned by the respondents match the most frequently named challenges of the existing sourcing practices in the volatile market (Russell & Smith, 2009; Leach, 2012; Eisenhardt, 2002). Slower implementation of changes due to longer distances can be a threat in the unpredictable market (Eisenhardt, 2002).

The time zone differences are not always seen as a major issue. While two of the respondents admitted that it limits and weakens the communication, the third one had no problems with it, which partially supports the argument by Carmel & Abbott (2007) that technology is enough to shrink the gap between distant locations. Surprisingly enough, Company Z, which has highly customized items, is the one not affected by the less direct communication. On the other hand it can be explained by the problems the company has encountered with language barriers. If the Chinese personnel cannot understand English without an interpreter the communication is limited already without time zone differences. The companies not owning the factory in China face lower degrees of control over its operations which requires them to employ on-site personnel as visits to the site are less frequent or rely on the local management.

#### **6.3.4 Economic Distance**

Availability (Alon et.al, 2007) and cost of labour is clearly expressed as the main advantage of sourcing in China both by the respondents and researchers (Engardio, Arndt and Foust, 2006; Kumar and Kopitzke, 2008; Ferreira & Prokopets, 2009). However, all of the interviewees noted that the labour costs in China have been indeed rising significantly (Bohn, 2012; Leach, 2012) showing the signs of increased industrialization of the country (Fung, Iizaka & Tong, 2002; Taube & Ogutcu, 2002; Kang, Wu & Hong, 2009). The previously mentioned unfavourable currency rates add to this argument.

While the overall technological capabilities and labour skills have been ranked as satisfactory on some cases when a more specific knowledge is needed, an investment in training might be required. These results present the reasons why China is losing its role as purely low-cost location (Leach, 2012), however, it is still very appealing for production which requires manual labour (Kumar & Kopitzke, 2008) like in the case Company Y. In contrary, two of the interviewees had encountered production delays or training costs because of the high turn-over levels of employees, supporting previous research that off-shore locations do have higher turn-over rates on workers (Kumar et.al, 2009). Companies that do not sell to the Chinese market can still take advantage of the economic arbitrage retrieved from cheaper labour and natural resources (materials) from manufacturing in China (Ghemawat, 2001).

Even though cost cutting is usually seen as the primary reason and benefit to outsource to China (Kumar & Kopitzke, 2008), companies must keep monitoring the quality of the outsourced processes or operations (Jennings, 1996; 2002). The argument of Biederman (2006) that over time the quality of goods produced in China with the lack of communication, monitoring and benchmarking steadily decreases, was indirectly agreed on by the respondents. Even in cases when the buyer company had invested in the technology and training of the staff, quality controllers of the buyer company or of third-party were employed to ensure it on the site showing signs of mistrust by the buyer companies.

The vast amount of available workforce increases the available capacity of production of scale (Kumar & Kopitzke, 2008; Hameri & Hintsu, 2009) which has been noted as another advantage of manufacturing in China by the respondents. At the same time, based on its impact on inventory and shipping strategies manufacturing in China might not be so efficient for companies not pursuing or requiring large quantities of goods. It has also been noted that the payment conditions in China – pre-paid orders, add a burden on small companies.

## **6.4 Eastern-Europe-Specific Distance Factors and Their Impact**

*RQ4: What is the impact of the cultural, administrative/political, geographical and economic factors specific to Eastern Europe that would determine whether a company should start, continue or discontinue outsourcing manufacturing in the country?*

### **6.4.1 Cultural Distance**

Based on the theories that cultural differences are the main barrier for successful cross-border business relationship (Wendell, 2009) and that there are no significant cultural differences between the Eastern and Western Europe (McNulty, 1992) one might think that no misunderstandings would arise. While two of the respondents indeed could not recall any issues arisen from cultural differences or social norms, in the third case the interviewee however stated the opposite even though all three studied companies have business operations in one and the same country - Poland. If the Chinese do not express their true thoughts, then according to one of the respondents, Eastern Europeans seemed too straight forward and offensive even if they did not mean it which had caused misunderstandings. It must be stressed again that within Eastern Europe itself the various countries can be divided into separate blocs based on national characteristics (McNulty, 1992; Coffe & van der Lippe, 2009) and no generalizations can be drawn as it also depends on each specific case.

The knowledge of English in Eastern Europe has been noted higher than the one in China. Nevertheless, it is not said that it is still not problematic at times. However, due to the fact that the countries share historical ties and free movement within the EU (European Commission, 2012a), there is a higher likelihood for companies in Europe in general to have an international and multi-lingual staff (Tagliabue, 2007).

In contrast to the experiences in China when a certain level of mistrust in the local management was obvious (e.g. hiring of external control teams), the issue was never mentioned in terms of Eastern Europe. While it might be due to the closer distances which increase the control level of the buyer, another reason could be that Eastern European managers are among the highest skilled in the world (McNulty, 1992; AHK, 2012).

### **6.4.2 Administrative/Political Distance**

No legal or bureaucratic, or IPR issues had been noted, however, just like in the case of China, the actual situation can vary. Firstly, the level of exposure to this particular distance factor depends on whether the facilities are owned by the buyer company or by a third-party. Secondly, since the majority of the countries in the region are members of EU as mentioned before, they also have to apply to certain common laws and policies. Therefore, foreign companies might not be faced with the questionable practices that might be more common among the local businesses. Eastern European countries have always been questioned about their bureaucracy and corruption heritage from Soviet Union and have strived to diminish this opinion ever since the 1991 with differing levels of success (Dionisie & Checchi, 2008; AHK, 2012). An open practice of these internal problems with foreign partners would set back the development of the countries due to lower amounts of FDI and harm their still scrutinized reputation on their way to "Westernization". The highest concerns about corruption remain the most evident about the non-EU countries.

Safety and environmental standards have already been established and met before the foreign companies signed the deal. Thus, the buyer company can save money that would otherwise be required to invest into a low-cost country supplier to meet the set standards as

they tend not to be on the same level (Eisenhardt, 2002). This again might be explained via the minimum requirements set by EU that the member countries have to follow. However, on very few occasions certain countries of Eastern Europe pay more attention and effort to these standards than legally required (Kilis, 2007) as pointed out in previous researches (AHK, 2012).

While it might be only a coincidence that all three of the studied companies outsource to Poland there is another possible explanation. Historical and political kinship is argued to be a pre-determinant for more successful cross-border relationships (Ghemawat, 2001; The World Bank, 2010). Thus, past experience or references from other companies increase the trust in a specific country and/or company and the likelihood to source there.

The stability of the Eurozone was expressed a possible concern for the future of outsourcing in the Eastern Europe as unstable economy can disrupt business operations (Ghemawat, 2001; FDIC, 2004). Currently only Estonia from all of the Eastern European countries has Euro as national currency while the majority is planning to join in the near future. In addition, national currencies in the region are often pegged to Euro, thus the stability has a great impact.

### **6.4.3 Geographical Distance**

The shorter physical distance results in small time zone differences, thus, the communication between the partners is more constant and allows frequent on-site visits if required. This in turn decreases the dependence on the local management as the degree of control is higher and takes less effort (Kumar et.al, 2009). Costs of hiring someone to be on the site are eliminated and closer relationships can be achieved, which is necessary for an effective management of strategic goods (Kraljic, 1983). However, the interviewed companies spent less time visiting the Eastern European than the Chinese suppliers, meaning that the geographical distance did not impact this matter as such.

Significantly shorter lead-times are mentioned as one of the main advantages of production in Eastern Europe both by researchers (Hoffman, 2008, Ferreira & Prokopets, 2009; Martin & Holweg, 2011) and respondents. While some buffer stock is still necessary to ensure the sustainability of the business (Hoffman, 2008), the inventory levels are notably lower. **Up till recently, manufacturing in low-cost countries was based on make-to-stock strategy to fully exploit the cheap labour and efficiently manage shipment costs.**

### **6.4.4 Economic Distance**

Price and cheaper labour are also named by the respondents as the primary factor when sourcing in Eastern Europe. This presents that in terms of cost advantages Eastern Europe lays in-between Sweden and China (Tagliabue, 2007; Werner, 2009). However, these cost differences differ greatly depending on specific Eastern European countries (Coffe & van der Lippe, 2009), thus differing total landed costs are not uncommon between the countries.

The technical competencies and labour skills are ranked as high and satisfactory by the respondents; in contrast, the statistical data show that this may change in the future. One of the major drawbacks of Eastern Europe in comparison to China, when it comes to outsourcing of manufacturing, is the changing demographics. On average, the Eastern European population is progressively decreasing and aging and there are high emigration rates (Perlitz, Schulze & Wilke, 2010). Even more so, an increasing number of people are attend-

ing universities to receive managerial degrees, which might result in a shortage of skilled factory-floor workforce (McNulty, 1992; AHK, 2012).

## 6.5 Discussion of Outsourcing to China vs. Eastern Europe

Items of high economic value but also with wide possible supplement base are most prone to outsourcing in China; therefore, availability and price are the main determinants during the decision making process. Standardized, high volume and high value-to-weight goods allow exploiting the far-sourcing location in the most efficient way via bargains for the lowest cost. An arms-length relationship in the dyadic and internal management between the buyer and supplier is the most effective strategy.

In addition to manufacturing leverage goods, items of high economic value but with different degrees of substitute possibilities are also eligible for outsourcing to Eastern Europe. Long-term availability of the product and reliability on the supplier is more effectively exploited via the possible of closer relationships and higher collaboration. In cases when low cost is the primary factor standardized products of medium/high added value allow the utilization of the benefits of Eastern Europe. When technical advancement is the driver of the outsourcing process customized products with high economic value permit an effective exploitation of Eastern Europe as an outsourcing destination.

In general, the answers from the respondents confirmed the theory regarding product characteristics. In most cases, the companies started the outsourcing with leverage items to a specific destination, and then gradually outsourced strategic goods as well.

The language barrier is very evident in China, which complicates the process for customized products as they require a higher collaboration between the company and supplier. Outsourcing standardized products may therefore exploit the benefits of outsourcing to China to a higher extent, as higher collaboration and communication would require extra resources. For more customized items whose development and manufacturing require frequent communication, feedback and collaboration Eastern Europe is thus a more preferred manufacturing location.

The difference in social norms could be seen both in China, where the staff were not encouraged to speak their minds and question the work processes, and in Eastern Europe, where the staff were very straight forward in their communication. Although there were negative aspects of the cultural dimension in both destinations, the respondents seemed to be in agreement that the cultural differences between Eastern Europe and Sweden had almost no effect on the buyer-supplier relationship. Administration costs were very high in China, due to the lack of trust in the ability of Chinese suppliers to work independently and meeting the requirements set by the companies. Here, the Eastern European suppliers required less visits and the companies found them more reliable in general.

The geographical distance had a great impact on the inventory policies and was seen as a clear negative for outsourcing to China. The fact that Poland is very close to Sweden caused very little, if any, issues in relation to inventory policies. It also caused a higher damage rate than for the goods produced in Eastern Europe. This means that components or products with a high value holds a bigger risk if outsourced to China.

The greatest benefits for economic distance could be found in China. They have historically, and still is the cheapest country to source labour from. However, the costs are rising in a high pace which has attracted all of the respondents' attention to Eastern Europe. The fact that many companies had already invested in China implied that those were sunk costs and

that reversing a decision to completely discontinue outsourcing to China would be too costly. Also, due to the capacity of China in terms of labour and the large number of firms being present, economies of scale is a big advantage of the country.

The significance and effects of the CAGE factors differ if the manufactured products are also sold in the off-shore country of choice. Certain industries and products are more affected by the specific market and customer characteristics not only by the differences of the overall environment.

Based on the product characteristics economic factors are the most influential for the decision to outsource to China, while cultural and geographical factors favour the products outsourced in Eastern Europe.

## **7 Conclusions**

Geographical factors are of a great importance when it came to inventory policies, where it creates unpredictability due to longer lead-times, which causes bigger safety stocks, as well as damages the products. For companies producing highly customised products, applying Just-in-Time policies, or producing goods with a very high end-value, this should be part of the calculations for possible costs.

Price is still the dominant factor for Swedish manufacturers as to why they have initially chosen to start producing in China. One of the key issues with regards to outsourcing to China is indeed the concern of drastically increasing costs for labour. In general, it is still cheaper to manufacture goods in China for Swedish manufacturers; however, managers should be aware of this and monitor the progress and growth of China. The costs measured in such calculation should of course take all costs into consideration, such as the tangible and intangible costs associated. This can be of particular importance when the company is also selling their products in China.

Outsourced manufacturing in China is influenced the most by cultural and geographical factors. The factors of cultural distance have a significant effect on the administrative issues between the buyer and supplier while the factors of geographical distance impact the issues of logistics, which in both cases complicate the cross-border partnership. On contrary, manufacturing operations outsourced to Eastern Europe are affected the most by economic factors via the Total Landed Cost of the manufactured goods.

Most of the progresses of Eastern European countries to become an attractive destination for outsourcing arise from their membership in EU. Administration and management is eased due to common policies, trade liberalization and agreements. The fact that some countries in Eastern Europe are members of EU was seen as a clear advantage, assuring that certain standards had to be in place and that common laws were in place. Based on this, in cases when the manufacturer wants to enter the market it outsources the manufacturing to Eastern Europe holds an advantage. However, there was a concern that there was a high corruption level in these countries in general, especially in the countries outside the EU. Administrative/political distance is thus not as important when the buyer company does not own and run the factory directly. Usage of a local middle-man decreases the exposure to the actual barriers of these factors; therefore an obstacle of experienced and expected factors arises.

All of the items whose manufacturing is outsourced from Sweden have a high economic/added value. Swedish manufacturers in general are not too keen of outsourcing and

losing the control over the specific processes, a common thread of in-sourcing and back-sourcing preferences can be sensed. More so, even though companies name TLC as the final determinant of the outsourcing decision thus also takes the “soft” factors into the consideration it is noticeable that the firms are not fully aware of all of these factors or their possible indirect effects. In addition, the importance of cross-cultural teams is growing in importance when a company outsources and sells over different markets.

Companies which have sourced from China for years have established long-term reliable relationships and made certain investments, at least intangible ones like time. Therefore, it would be very costly for companies to just leave China and start the outsourced processes all over in Eastern Europe. A more gradual shift over time is more likely, especially if the industrialization of China will continue at the current pace.

The physical size of certain Eastern European countries might be an obstacle for near-sourcing as they are too small territorially, which may limit their capability to ensure the functionality and availability of the entire supply chain. On the other hand, the Eastern European countries due to their geographic location can serve as great logistics hubs for Northern Europe, Eastern Europe and Russia if the buyer company wants to enter or already serves these markets. The choice of a specific Eastern European country as an outsourcing location is highly depended on specific product characteristics and the main drivers of the outsourcing decision. A country specific assessment of its pros and cons for an outsourcing of a certain product has to be carried out to reach the most efficient and effective results.

## **7.1 Limitations and Future Research**

The research has been an interesting experience and given the authors a good insight to Swedish manufacturers outsourcing experiences. The data obtained through the interviews did indeed confirm much of the theories and literature review conducted, but also contradicts some parts of it.

Although the interviews were seen as very successful by the authors, it was evident that some of the respondents were reluctant to elaborate on their answers, which might have resulted in withholding certain information. Also, the respondents might have kept information about failures and unsuccessful strategies and practices to themselves.

There were difficulties finding suitable respondents that were both outsourcing to Eastern Europe and China. This can be related back to the fact that near-sourcing has been relatively new phenomena. Also, when the companies received the interview guide, some felt a bit overwhelmed and that it would be too time consuming. It would have been desirable to conduct more than one interview with each of the respondents to gain more knowledge about specific supplier relationships, however, this could not be done due to both time constraints of the respondents and authors.

The small sample was a concern for the authors which made generalisation of data difficult, however, as the authors had set out to collect data through in-depth interviews in combination with time constraints, the sample size was more realistic and helped to form a ground for comparison. The authors also experienced some difficulties to get a full overview of the phenomenon as it has several terms depending on author and field.

The authors felt as if there was a lack of the supplier’s point of view, and would therefore find it very meaningful to analyse an offshore outsourcing buyer-supplier-relationships from both ends. The view from the offshore suppliers would indeed be very interesting to

analyse in contrast with the view from the Swedish companies. It would serve as a good basis for analysing actions and the outcomes of such actions.

Another interesting topic that arose during the interview process was the phenomena of in-sourcing activities. One of the respondents even felt that he would have preferred to bring all activities if it was economically possible. It would be interesting to explore the drivers of in-sourcing and the barriers that exist.

## **7.2 Managerial Implications**

Managers can use the results as a guide for what product characteristics that can be outsourced and the experienced company specific characteristics that will have an impact on such outsourcing decision. Identifying the CAGE Dimensions of the country that the company wish to outsource to could be very useful in order to prevent possible misunderstandings. It could also potentially prepare the company for challenges that they may face once the outsourcing decision has been put in action.

The holistic approach of the research has proven the management or decision making teams should continuously monitor and re-evaluate the current outsourcing locations. Alternative strategies should be developed so the supply chain of the company is responsive to the changes of market and consumer behaviour.

Companies pursuing JIT, customization or procurement strategies, or having products of high end value should pay extra attention to the “soft” and “hard” factors of each outsourcing destination. Price is certainly an important factor and should not be ignored. However, it is important for managers to take a more holistic view of all associated costs for the outsourcing decisions. By only looking at the price directly related to the product, unforeseen indirect prices can quickly erase those benefits, and it is therefore of importance to calculate all costs seen from different angles. Also, the economic geography is undergoing constant changes, which should be taken into consideration. It also shows that perhaps managers should constantly review the benefits and drawbacks of the outsourcing options and change to a more flexible strategy.

As companies of all sizes do outsource their manufacturing activities, multi-national teams and cross-cultural awareness should become a standard of the company to fully exploit the benefits of outsourcing.

Each company when deciding on an outsourcing location, should do its own research not base the end decision on an information or opinion of a third party. Failure to do so may result in incomplete or misleading picture of the situation; the expected and experienced barriers may not be one and the same.

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# Appendices

## Appendix 1

### *“Factors Influencing the Strategic Importance of the Purchase”*

#### Competence factors

1. The extent to which the purchase is part of the firm’s core competencies.
2. Purchase improves knowledge of buying organization.
3. Purchase improved technological strength of buying organization.

#### Economic factors

1. Volume or dollar value of purchases.
2. The extent to which the purchase is part of a final product with a great value added.
3. The extent to which the purchase is part of a final product with a good profitability.
4. Criticality of the purchase to get leverage with the supplier for other buys.

#### Image factors

1. Supplier critical image/brand name.
2. Potential environmental/safety concerns.

(Olsen & Ellram, 1997, p. 104)

## Appendix 2

### *“Factors Describing the Difficulty of Managing the Purchase Situation”*

#### Product characteristics

1. Novelty.
2. Complexity.

#### Supply market characteristics

1. Suppliers’ power.
2. Suppliers’ technical and commercial competence.

#### Environmental characteristics

1. Risk.
2. Uncertainty.

(Olsen & Ellram, 1997, p. 104)

## Appendix 3

### Interview questions (English version)

#### *Part 1 – Manufacturing in China*

1. How is it decided where should the production be outsourced to?
2. Has your company outsourced manufacturing or other business processes to China?
3. What product or products have you chosen to manufacture in China?
4. What reasons did you have for choosing to outsource to China?
5. To what extent would you say that the products you manufacture in China have an impact on your core competencies?
6. What is the difference between the end-value of the goods you manufacture in China in comparison to your other products? And if you only manufacture components in China, what is the difference of the end-value of the finished product in comparison to your other products?
7. Do the products you have chosen to manufacture in China require specific investment, knowledge or technology in comparison to other products? If so, which ones?
8. What type of products do you manufacture in China: new ones or well established?
9. How do the products manufactured in China differ from the ones produced somewhere else in terms of: parts required, difficulty of final assembly, specially educated staff, need for trial period?
10. What types of products are manufactured in China: standardized or customized? What is the reason behind this choice?
11. Has the fact that you outsource to China had an impact on your company's image from both customer and shareholders point of view? If yes, how?
12. Have you encountered problems with safety standards related to the products you have chosen to produce in China? If so, which ones?
13. How does the manufacturing in China meet your environmental goals? If so, how?
14. How many suppliers in the region you outsource in China meet your requirements?
15. How big are the suppliers that you work with in China (number of employees and customers)?
16. What type of relationships do you have with your suppliers in China in terms of reliability, duration and degree of collaboration?
17. To what extent is your company satisfied with the technological and labour skills in China?
18. Has your company experienced any problems related to intellectual property theft when outsourcing in China?
19. What impact has the decision to manufacture in China had on your company's inventory strategy?
20. What effect have you and your suppliers speaking different languages had on your business?
21. A) Are there big cultural differences between your organization and your suppliers in China? Give examples.

- B) How has this impacted your collaboration?
22. How does the geographical distance impact your relationship with your suppliers in China?
  23. What are the economic benefits for manufacturing in China? What economic disadvantages are there?
  24. What political and legal factors influence and impact your decision and future relationships with your suppliers in China? If so, can you give example of them? How did it affect your business?

*Part 2 – Manufacturing in Eastern Europe*

25. Has your company outsourced manufacturing or other business processes to Eastern Europe?
26. What product or products have you chosen to manufacture in Eastern Europe?
27. What reasons did you have for choosing to outsource to Eastern Europe?
28. To what extent would you say that the products you manufacture in Eastern Europe have an impact on your core competencies?
29. What is the difference between the end-value of the goods you manufacture in Eastern Europe in comparison to your other products? And if you only manufacture components in Eastern Europe, what is the difference of the end-value of the finished product in comparison to your other products?
30. Do the products you have chosen to manufacture in Eastern Europe require specific investment, knowledge or technology in comparison to other products? If so, which ones?
31. What type of products do you manufacture in Eastern Europe: new ones or well established?
32. How do the products manufactured in Eastern Europe differ from the ones produced somewhere else in terms of: parts required, difficulty of final assembly, specially educated staff, need for trial period?
33. What types of products are manufactured in Eastern Europe: standardized or customized? What is the reason behind this choice?
34. Has the fact that you outsource to Eastern Europe had an impact on your company's image from both customer and shareholders point of view? If yes, how?
35. Have you encountered problems with safety standards related to the products you have chosen to produce in Eastern Europe? If so, which ones?
36. How does the manufacturing in Eastern Europe meet your environmental goals? If so, how?
37. How many suppliers in the region you outsource in Eastern Europe meet your requirements?
38. How big are the suppliers that you work with in Eastern Europe (number of employees and customers)?
39. What type of relationships do you have with your suppliers in Eastern Europe in terms of reliability, duration and degree of collaboration?
40. To what extent is your company satisfied with the technological and labour skills in Eastern Europe?

41. Has your company experienced any problems related to intellectual property theft when outsourcing in Eastern Europe?
42. What impact has the decision to manufacture in Eastern Europe had on your company's inventory strategy?
43. What effect have you and your suppliers speaking different languages had on your business?
44. a) Are there big cultural differences between your organization and your suppliers in Eastern Europe? Give examples.  
b) How has this impacted your collaboration?
45. How does the geographical distance impact your relationship with your suppliers in Eastern Europe?
46. What are the economic benefits for manufacturing in Eastern Europe? What economic disadvantages are there?
47. What political and legal factors influence and impact your decision and future relationships with your suppliers in Eastern Europe? If so, can you give example of them? How did it affect your business?
48. What are the differences between total manufacturing costs in China and Eastern Europe?

## Appendix 4

### Intervju guide (Swedish version)

#### *Del 1 – Tillverkning i Kina*

1. Hur bestäms var produkten skall tillverkas?
2. Har Ert företag outsourcat Er tillverkning eller andra arbetsprocesser till Kina?
3. Vilken produkt/ Vilka produkter har Ni valt att producera i Kina?
4. Vilka skäl hade ni till att placera tillverkningen/arbetsprocessen i Kina?
5. I vilken utsträckning skulle Ni säga att produkten/del av produkten Ni outsourcar till Kina har en inverkan på Er kärnkompetens?
6. Vad är skillnaden mellan det slutgiltiga värdet för produkten Ni producerar i Kina i jämförelse med Era andra produkter? Om Ni enbart producerar komponenter i Kina, vad är skillnaden mellan det slutgiltiga värdet av den produkten där komponenten används i jämförelse med Era andra produkter?
7. Kräver produkterna Ni valt att producera i Kina specifik investering, kunskap eller teknologi i jämförelse med andra produkter? I så fall, vilka?
8. Vilken typ av produkter tillverkar Ni i Kina: nya eller redan väletablerade?
9. Hur skiljer sig de produkter Ni producerar i Kina jämfört med Era andra produkter med hänsyn till: antal delar som behövs, svårighet av slutmontering, behov av specifik kompetens, behov av en test period?
10. Vilken typ av produkter tillverkas i Kina - standardiserade eller skräddarsydda? Vad är skälet till detta val?
11. Har det faktum att Ni lägger ut din tillverkning i Kina påverkat Ert företags image ur kunders eller/och aktieägares synpunkt? Om ja, på vilket sätt?
12. Har det uppstått problem med säkerhetsstandarden relaterat till produkterna Ni valt att producera i Kina? I så fall, vilka?
13. Har Era miljömål mötts efter att Ni valt att outsourca till Kina? I så fall hur?
14. Hur många leverantörer i regionen där ni outsourcar i Kina möter Era krav?
15. Hur stora är leverantörerna Ni samarbetar med i Kina (antal anställda och antal kunder)?
16. Vilken typ av relation har Ni med Era leverantörer Kina när det gäller tillförlitlighet, varaktighet av samarbete och grad av samarbete?
17. I vilken utsträckning är Ert företag nöjd med de teknologiska kompetenser och arbetskraft Kina har att erbjuda?
18. Har Ert företag upplevt problem relaterade till stöld av immateriella rättigheter i samband med outsourcing till Kina?
19. Vilken inverkan på Ert företags lagerstrategi har outsourcing till Kina?
20. Vilka konsekvenser har Ni upplevt av att Ni och Er leverantör i Kina pratar olika språk? Ge exempel.
21. a) Finns det en stor kulturell skillnad mellan Er och Er leverantör i Kina? Ge exempel.  
b) Hur har detta påverkat Ert samarbete?
22. Hur påverkar det geografiska avståndet Er relation med Er leverantör i Kina?

23. Vilka är de ekonomiska skäl till att ni valt att outsourca till Kina? Vilka ekonomiska nackdelar finns det?
24. Vilka politiska och juridiska faktorer påverkar Ert beslut och Er fortsatta relation med Er leverantör i Kina? Kan Ni ge exempel? Hur påverkar det Ert företag?

*Del 2 – Tillverkning i Östeuropa*

25. Har Ert företag outsourcat Er tillverkning eller andra arbetsprocesser till Östeuropa?
26. Vilken produkt/ Vilka produkter har Ni valt att producera i Östeuropa?
27. Vilka skäl hade ni till att placera tillverkningen/arbetsprocessen i Östeuropa?
28. I vilken utsträckning skulle Ni säga att produkten/del av produkten Ni outsourcar till Östeuropa har en inverkan på Er kärnkompetens?
29. Vad är skillnaden mellan det slutgiltiga värdet för produkten Ni producerar i Östeuropa i jämförelse med Era andra produkter? Om Ni enbart producerar komponenter i Östeuropa, vad är skillnaden mellan det slutgiltiga värdet av den produkten där komponenten används i jämförelse med Era andra produkter?
30. Kräver produkterna Ni valt att producera i Kina specifik investering, kunskap eller teknologi i jämförelse med andra produkter? I så fall, vilka?
31. Vilken typ av produkter tillverkar Ni i Östeuropa: nya eller redan väletablerade?
32. Hur skiljer sig de produkter Ni producerar i Östeuropa jämfört med Era andra produkter med hänsyn till: antal delar som behövs, svårighet av slutmontering, behov av specifik kompetens, behov av en test period?
33. Vilken typ av produkter tillverkas i Östeuropa - standardiserade eller skräddarsydda? Vad är skälet till detta val?
34. Har det faktum att du lägger ut din tillverkning i Östeuropa påverkat Ert företags image ur kunders eller/och aktieägares synpunkt? Om ja, på vilket sätt?
35. Har det uppstått problem med säkerhetsstandarden relaterat till produkterna Ni valt att producera i Östeuropa? I så fall, vilka?
36. Har Era miljömål påverkats av Ert val att outsourca till Östeuropa? I så fall hur?
37. Hur många leverantörer i regionen där ni outsourcar i Östeuropa möter Era krav?
38. Hur stora är leverantörerna Ni samarbetar med i Östeuropa (antal anställda och antal kunder)?
39. Vilken typ av relation har Ni med Era leverantörer Östeuropa när det gäller tillförlitlighet, varaktighet av samarbete och grad av samarbete?
40. I vilken utsträckning är Ert företag nöjd med de teknologiska kompetenser och arbetskraft Östeuropa har att erbjuda?
41. Har Ert företag upplevt problem relaterade till stöld av immateriella rättigheter i samband med outsourcing till Östeuropa?
42. Vilken inverkan på Ert företags lagerstrategi har outsourcing till Östeuropa?
43. Vilka konsekvenser har Ni upplevt av att Ni och Er leverantör i Östeuropa pratar olika språk?
44. a) Finns det en stor kulturell skillnad mellan Er och Er leverantör i Östeuropa? Ge exempel.  
b) Hur har detta påverkat Ert samarbete?

45. Hur påverkar det geografiska avståndet Er relation med Er leverantör i Östeuropa?
46. Vilka är de ekonomiska skäl till att ni valt att outsourca till Östeuropa? Vilka ekonomiska nackdelar finns det?
47. Vilka politiska och juridiska faktorer påverkar Ert beslut och Er fortsatta relation med Er leverantör i Östeuropa? Kan Ni ge exempel? Hur påverkar det Ert företag?
48. Vilka skillnader i den totala tillverkningskostnaden finns det mellan Kina och Östeuropa?

## Appendix 5

### Case Study Company Profiles

#### *Company X*

Company X was established in the 1940s and is a Swedish developer and producer of customized light installations for public environments such as offices, schools, retail outlets, industrial plants and sports halls, outdoors, and health care buildings. The company has around 110 employees and is present in nearly 20 countries across the globe as part of a larger group of manufacturers. The firm and its production activities have acquired and work under ISO 14001 and 9001 certificates to ensure and fulfil their corporate social responsibility standards.

The company has been outsourcing to China from 2007 and has since transferred their own factory there as well where it produces high-volume components and finished goods using a wide network of about 100 local suppliers. Sales companies in Eastern European (EE) countries of Estonia, Poland and Slovakia are limited at present to acquisition of standardized components only. Reduction of costs to remain competitive was given as the main reason why the company outsources to both China and EE. The decision is based on the total cost – “landed cost, including tax, freight, cost for bound capital, need of buffer stock etc.” with volume and flexibility of demand as the main drivers.

#### *Company Y*

Company Y is a furniture designer and manufacturer founded in the 1940s. Currently 95 workers are employed in Sweden and its product portfolio includes barstools and stools, benches and modular seating, easy chairs and sofas, and tables and trolleys, which are exported internationally. The firm is ISO 14001 and 9001 certified to meet the environmental goals and high quality standards they strive for.

Company Y has eight suppliers in China where it manufactures standardized components of high volume. The company started outsourcing to China in 2000 because the production of specific components was mostly manual and very time consuming, which increased the labour costs if manufactured in Sweden. Since the middle of 2011, the company is sourcing the manufacturing of a more customized product from Poland. The company does not outsource finalized products and does the final assembly in its factory in Sweden itself. Quality, price and the size of a specific product are the determinants of an outsourcing decision.

#### *Company Z*

Founded in 1989, Company Z is a prototype and custom made solution products- and system manufacturer of cable harnesses and electro mechanics. The firm is a subcontractor for international Swedish companies in the fields of industrial robot, automatic door, lifting tackle, gasoline pump, elevator and exhaust extraction systems, warehouse logistics, and foodstuff industries. Company Z currently has 26 employees in Sweden and has acquired an ISO 9001 certificate to meet its low costs – high quality strategy.

Company Z has been outsourcing its manufacturing to China for about eight years and to Poland nine years. Currently about 50 percent of the products are manufactured in Sweden, 20 percent in Poland, and 30 percent in China. Sales, manufacturing and warehouse functions are placed in Sweden since the firm aims to keep as much of its operations in Sweden

as possible. However, the external pressure from its customers has forced Company Z to look for other production alternatives in low-cost countries.

As all of the products that Company Z manufactures are highly customized depending on the requirements of the customers, the customer usually gives signals where the production should be done depending on the price factor.