

7 Strategies to Minimize Risk When Outsourcing Production to China

**How to Get Exactly What You Ordered
On Time, In Perfect Condition, and for
the Contracted Total Landed Cost**

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Risk-minimizing strategies go far to maximize the value of outsourcing overseas.

If your company is currently outsourcing its manufacturing, printing or packaging production overseas, it is very likely you have experienced the following:

- Production errors
- Hidden costs or extra charges
- Damaged goods
- Inconsistent quality
- Delayed or late delivery

Though the economical upside to outsourcing manufacturing and print production overseas can look very attractive on the surface, cultural and communication differences frequently create issues and delays that can cost far more than the anticipated savings. If your procurement department or agent does not understand the cultural nuances of doing business in China – and how to use them to the greatest advantage - problems can quickly escalate until any savings in time or money is lost or extra fees and penalties are incurred.

The risk minimizing strategies presented here are based on the experience Supply Solutions Network obtained over the last half-dozen years while managing the production of thousands of projects through its buying office in China. When applied, these strategies can help you maximize the considerable savings that can be realized when outsourcing to China. This report explains:

1. How to mirror Chinese business etiquette to gain trust and smooth negotiations
2. How to ask open-ended questions to understand what is really being said by a Chinese resource
3. Why it is critical to use engineering-savvy translators
4. How to get the most from a Letter of Credit
5. Why the fine print in an insurance policy may not cover every shipment
6. How special customs duties can negatively impact Total Landed Costs
7. How to match Total Landed Cost to the original quote

STRATEGY #1

Mirror Chinese Business Etiquette

When dealing with the Chinese people, you should remember that respectful rituals surround even the simplest interactions. Following Chinese business etiquette, which at first may seem too formal for those from the United States, is very helpful for building strong relationships with overseas partners and suppliers. Don't you tend to trust those whom you feel comfortable with? The Chinese are no different. When you respect their culture and way of doing business, they feel more comfortable with you and therefore you gain their trust. Here are a few tips you should know:

The Business Card Exchange

- It is a good idea to have plenty of business cards on hand when attending meetings as the Chinese businessperson hands out their cards to everyone.
- If possible, have your name printed in Mandarin on the back of your cards. Ask a close Chinese associate or friend to help you determine an appropriate name or utilize an online resource like www.mandarintools.com to create one.
- Always stand up when exchanging business cards with someone who has a superior position to your own.
- When you are handed a business card, bow slightly and take it with your right hand or in both hands and read it completely before putting it safely in a front pocket or on the table in front of you.
- Do not put the business card in a back pocket as this would be a sign of disrespect.
- Say the person's name and position to be sure of correct pronunciation.

Business Meeting Protocol

- Wait to be shown to your seat as seating arrangements are determined by the status or organizational position of the participants.
- The highest ranking person usually sits at the head of the table facing the door, with those in next highest positions sitting closest to him or her. You should stand at your seat before being seated. Again, the highest ranking person will indicate when everyone should be seated. He or she will also be the first one to stand at the end of the meeting.
- When you take notes during a business meeting in China it shows you are interested and attentive. Only use a pen with blue or black ink, however, and never write anyone's name – even your own – in red as the ancient Chinese reserved this color for the dead.

- You may want to bring a small souvenir that represents your company or hometown to present to your host. Gifts of this kind are always appreciated. You may receive a gift from your host as well. If it is wrapped, do not open it until you leave. If it is not wrapped, make sure to express sincere appreciation and ask questions about the gift to show your interest.

Mirroring Chinese business etiquette goes a long way to build strong relationships with overseas sourcing management, employees and production partners. Most likely you were taught this as a child – show respect and you will receive respect in return. A solid relationship built on trust will make it easier to reduce production errors, eliminate hidden costs or extra charges, avoid damaged goods, produce consistent quality and assure on-time delivery.

STRATEGY #2

Ask Open-ended Questions to Clarify Communications

Why the Chinese Can't Say "No"

Saving face – or maintaining respect – is key to the Chinese culture and especially so when conducting business. Saving face is so important to the Chinese that it is not possible for them to say “no” to “yes or no” questions. When you ask “Will you meet delivery on the 15th of next month?” and they answer or nod “yes”, that “yes” could mean “we’ll do what we can” or “I’m not sure” or any number of things besides the positive “yes” you are looking for. Without that positive yes, you have no guarantee you will have delivery anywhere near the 15th. Instead of asking yes or no questions, we recommend framing requests made to Chinese sources so as to learn exactly what they think is possible and what they are prepared to do or not do to meet your requirements, all without imposing mandates.

The Case of the Missing Backpacks

Procurement people may have experience in their specific area but not in “the China purchase” so they seek outside help in order to take advantage of a very cost-effective production solution. One U.S. purchasing director got in a real bind when her Chinese broker could not complete delivery on a pre-paid order.

Lynda Wilson (not her real name) thought she had done all her homework. The China broker who was handling her order for branded backpacks was personable, agreeable and gave her a good price. The backpacks would arrive just in time for her company’s annual meeting at an off-site

location. The broker had the address and dates when the convention center would be ready to receive shipment and had placed the order upon receiving full payment from Lynda's company.

Then 8,500 backpacks arrived at the convention center three weeks early. There was no warning and nowhere to unload the shipment. When Lynda got the call from the trucking company saying they had no place to unload, she scrambled to negotiate space for the backpacks at a local storage facility, and then scheduled a new pickup date with the trucking company so they would be delivered to the convention center on the original meeting date a few weeks later.

When Lynda called the China broker to complain he was sympathetic and understanding. However, when she asked when the balance of her order would arrive, he could not give her a definitive answer nor was he able to ensure they would even arrive in time for the meeting. With no other choice, she arranged to have the additional 5,500 backpacks produced locally so to meet the deadline.

What You Understand About “Saving Face” May Not Only Save Your Project – It Might Save Your Job

Remember, her company had already paid for the Chinese order in full. There would be new expenses for storage and redelivery of the first 8,500 backpacks, and now there would be an additional two to three times the original production price to be sure the remaining 5,500 backpacks arrived when needed. Lynda added a new worry to the one about getting all 14,000 backpacks to her meeting on time – now she was worried about keeping her job.

Had Lynda understood the Chinese concept of “saving face” she would have known how to proceed when the China broker said “yes” to her question about just in time delivery. She would have known to ask open-ended questions about the production process and delivery variables that would have minimized the risk of her order not arriving when it should.

When dealing with Chinese sources, it is important to frame questions carefully and listen attentively to answers. There is a great deal of difference between making a statement like “I expect the backpacks delivered at the convention center on the 15th!” and asking a question such as “Would you explain the production and delivery process?” Rather than make definitive statements it is better to suggest options and make proposals in general terms and see how your recommendations are received. When you push too hard, you may get the “yes” you want to hear – but the meaning will be closer to “we’ll do what we can”. No matter who you are dealing with, however, always conduct yourself by showing genuine interest and being respectful. Being respectful “gives face” and is fundamental to successful negotiations with the Chinese. When dealing with outsourcing to China, “giving face” can save yours.

“It’s the rule of our company.”

Another tip that can be very helpful when the Chinese are insisting on something you are not willing to do or cannot do is to say “It’s the rule of our company.” The Chinese will accept this statement at face value however it is best only to use it if it true or as a last resort during negotiations. You should expect your Chinese counterpart to use it as well, but keep in mind that it does not have to be an absolute “no” – you simply have more negotiating to do.

Finally, asking open-ended questions is all about communicating clearly. Clear communications go far to minimize production errors, eliminate hidden costs or extra charges, avoid damaged goods, produce consistent quality and assure on-time delivery.

STRATEGY #3

Use Engineering-savvy Translators to Guarantee Specifications are Met

As there are cultural nuances that must be considered when doing business with Chinese resources, there also are nuances in language that do not convey the original meaning that can cause confusion and errors when translated word for word. This is especially true when communicating complex or technical specifications that must be followed to the smallest detail.

The Case of the Confused Translator

Recently, a U.S. businessman visiting China decided to meet with a local church leader to offer his assistance while in country. He went with his business partner and an English-speaking Chinese associate who would be doing the translating.

During the conversations between the U.S. businessman and the Chinese priest, the business partner noticed the translator was hesitating and seemed to not be translating parts of the businessman’s conversation. When the partner took her aside to ask if there was a problem, she explained she was not a Christian and didn’t understand what the Chinese priest was saying so she couldn’t translate the meaning of those words into English. Even if she had understood the Chinese portion of the conversation, she had not had any training in English religious words while at the University.

To “Save Face” Chinese Translators May Not Translate Correctly

Though the above example involved religious terminology, you can see how this same situation could become a problem during business meetings if someone was using proprietary terminology, unique

engineering specifications, or words that sound the same in English but have more than one meaning – which can entirely change a message upon translation. Translators need to understand the meaning of the Chinese words before translating them into English and English words before translating them into Chinese. Most business negotiations fail early on because of misunderstandings of one kind or another; you do not want your hired translator to create problems for your project because they want to “save face” by not admitting they are having a problem understanding someone. Be sure your translators are very experienced so they do not make your negotiation any harder than it needs to be.

Utilizing translators who not only can translate everyday English into Mandarin or Cantonese but who also have a full understanding of English technical terms and engineering requirements will go far to reduce mistakes, ensure quality standards and save time. Using a U.S. managed buying office in China is one way to keep mistakes and misunderstandings to an absolute minimum.

STRATEGY #4

Make the Most of Letters of Credit

Use Letters of Credit to minimize your financial risk of doing business internationally. A letter of credit through your bank is a promise to the Chinese manufacturer that they will get paid as long as they do what they've agreed to do. Be sure everything you expect is spelled out clearly in the Letter of Credit. Specifics as to price, specifications, shipping instructions, delivery date, insurance coverage, etc. will provide protection if issues arise and you are not satisfied with their resolution.

Chinese Payment Terms

A word about payment terms; in the past several years many well-known U.S. companies have filed bankruptcy, so the Chinese are now reluctant to extend credit terms until after you have been doing business with them for some time. It is easy to understand that if they are not paid, it would be very difficult for a Chinese company to petition a U.S. court. Today, you can expect to pay an advance of 30% at the start of production, 40% during production and the balance upon completion.

STRATEGY #5

Be Sure Shipments are Insured for Full Replacement Value

In the United States, we have streamlined our docks to pack and load containers for efficiency and minimum damage to the goods being shipped. In the U.S. preparing goods so they are protected

while in transit does not start at the dock, it starts at the factory. That is not usually the case when shipping from a foreign port.

The majority of companies in China are small, family run operations with limited staff and resources. Unless specifically told how the buyer wants them to package, wrap and protect products for shipment, the following case illustrates what can happen.

The Case of the Muddy Makeup Kits

Let's follow the steps of 5,040 branded makeup kits that a U.S. procurement director got at a great Total Landed Price.

First, at the factory in China, the makeup kits are packed 24 to a case (for 210 cases) and the cardboard cases taped closed. A few men leave the production line to physically carry each case to an old truck outside and begin stacking the cases inside, one on top of the other. The truck leaves for the shipyard.

It's raining all the way to the shipyard. Everywhere there are puddles and mud. Once at the shipyard, the truck driver and perhaps a co-worker, unload the truck, dropping the cases of makeup kits onto the wet, muddy ground. From there they hoist a case on their shoulder to carry it to the container where it is loaded along side or on top of other products headed for the same destination port.

As the truck drives away, another arrives with 50 boxes containing 100 lb. exercise bikes. These are loaded on top of the makeup kits, sometimes being tossed in order to fill areas further back. Another truck arrives with lamps – packaged 3 to a box. These too make it into the container. More trucks follow. You get the idea. If you don't specify how you want your products packed and transported – they will find themselves loosely stacked in the back of an old truck being pelted by the elements.

But the journey of our makeup kits is not done. Once all boxes have been loaded and the container is full, its doors are closed and locked and the container is hoisted onto the ship. While at sea the ship experiences rough weather and high seas however, it appears that everyone and everything will make it safely to port.

Once at the dock in the United States, all cargo must be unloaded the same way it was loaded - separately. Many of the makeup kit cases are crushed, wet and covered in mud. There is a sound like broken glass coming from the lamp boxes as they are taken out of the container.

When the makeup kits arrive at their final destination, 35% of the shipment is damaged and cannot be used. The rest are covered in dried mud. The purchasing agent files a Yellow Freight claim and learns he is not covered.

How to avoid something like this happening to you? Always specify exactly how your products should be packed and wrapped for shipment from the moment it leaves the factory floor in China. And be sure to get adequate insurance that can fully cover replacement in case of damage, loss or theft.

STRATEGY #6

Identify Special Customs Duties

An unexpected duty – not anticipated or reported – can come as an unpleasant surprise to the U.S. purchasing agent and seriously impacts the total landed cost of his products produced overseas.

Surprise! Special Duty Imposes 114% Tax

For instance, cased pencils have an “anti-dumping” duty imposed on these imports that is 114% of their manufactured cost. Imagine the surprise for the purchasing agent when his \$10,000 order for 75,000 carpenters’ pencils ended up having a landed value cost of \$21,400.

If you do not wish to be unpleasantly surprised once your products reach port, you will be well advised to uncover and understand any special duties that may apply to your product and prepare for them ahead of time.

STRATEGY #7

Insist on Total Landed Cost

There can be many indirect costs that can impact the benefits of using China for your printing or manufacturing production. However, by using a qualified and experienced partner who has a proven in depth sourcing methodology in place and understands how to do business with the Chinese, your total landed cost can be the same as your original quote.

When compiling your Total Landed Cost, besides the unit cost of production, you need to include transportation fees, customs and duties, brokerage service fees both at origin and destination, bank charges, financing, insurance and any expedited freight charges that may come about due to changes in the supply chain.

You should consider product quality, whether the area of the country where your job is being produced has transportation options and the necessary infrastructure to deliver the goods, storage facilities, moving equipment and lift availability if required. Proximity, time zones, quality of their translators (and whether they have experience with your type of product) should also be considered.

You should thoroughly understand trade regulations, incentives, restrictions, and whether any special documentation is required. Include being certain the insurance coverage you have is enough to handle a total loss of the order.

To Summarize: A Case In Point

The Case of the Too-Technical Training Manual

The job was not a large one; just a few hundred training manuals of 400 pages each. The catch was they needed to be digitally printed. The U.S.-based manufacturer was building equipment in China for sale to the Chinese market. The manuals would fulfill just-in-time delivery and as equipment orders were placed and manufactured, more manuals would be needed. Though digital printing could be done easily in the United States, the manuals were needed in China and it made the most sense economically to print them there.

The problem was the customer's Shanghai purchasing agent. He did not have digital printing experience, did not know how to work digital equipment, did not understand the process, nor did he know anyone in country who could handle a digital printing job.

Supply Solutions Network was awarded the project. Our U.S.-based management team contracted with one of our digital printing partners in Hong Kong and clarified all specifications. Then our staff in Hong Kong managed the project from start to finish and delivered printed, shrink-wrapped manuals on pallets to Shanghai in time for them to be unloaded and packaged with the new equipment as it rolled off the assembly line.

About Supply Solutions Network

Supply Solutions Network (SSN) provides quality offshore printing, manufacturing and assembly solutions that reduce the risk and cost of procurement to small and mid-sized businesses. SSN is not simply a broker; we are a team of China outsourcing experts with almost 100 years of combined experience negotiating, managing and implementing real manufacturing and assembly solutions through our relationships both in the United States and China.

In-depth Sourcing Methodology Minimizes Risk

Since 2004, Supply Solutions Network has built the resources and established the relationships necessary both in China and the United States to successfully negotiate and manage projects totaling millions of dollars. Here in the States, our management team applies this experience to every offshore project we handle. SSN-US provides drawings, schematics, specifications, photos, and

other detailed descriptions directly to the SSN-China buying office. Our in-depth sourcing methodology involves completing a series of check points to ensure every production detail is understood and completed to original specifications.

Supply Solutions Network's office in Changzhou, China near Shanghai employs experienced procurement and project managers who are trained to get the best possible price and finished product for our customers. This team is fluent in the English language, including engineering terminology, which ensures specifications are clearly understood and communicated, and projects are produced and shipped as agreed.

What to do next...

Supply Solutions Network is offering eligible outsourcing companies a complimentary one-day **5-Point Outsourcing Analysis** conducted by a member of our senior management team which includes:

- 1) A review of your current outsourcing strategy and recommendations for enhancements or improvements
- 2) Meeting with your procurement team to discuss processes, metrics, costs, projections, and goals to determine if you are receiving the best value
- 3) Determining what, if any, processes should not be outsourced – and identify others where outsourcing would be beneficial
- 4) Providing measurable service level agreement standards for use when outsourcing
- 5) Assessing risk factors and how they can be minimized

To determine if you are eligible for our complimentary **5-Point Outsourcing Analysis** conducted on site at your location, email analysis@supplysolutionsnetwork.com with your contact information. A Supply Solutions Network outsourcing expert from our U.S. senior management team will contact you within 24 hours.



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