

Made in China: Better safe than sorry

WE TAKE A STEP BACK AND ANALYSE THE BLAME GAME CONCERNING THE QUALITY OF CHINA-MADE PRODUCTS.

20 years ago, "Made in China" represented cheap products that weren't up to par with Western standards. If you wanted your fridge, toaster or TV to work (and more importantly, to last) you had to invest a little more in a high-quality Western model. It was as simple as that: good quality had its price.

But with the rise of Chinese goods in the global market, customers around the world found that good quality at cheap prices was indeed possible. All over the world China-produced goods were praised for their competitive prices, while quality became less of an issue. The US, for example, ramped up toy imports from China and millions of American kids happily played with their China-produced GI Joes and Barbie dolls. It was not until Mattel's recent recall of lead-painted children's toys that the economic paradox of "more for less" became obvious.

There are two key questions that arise in the orbit of toxic toothpaste and poisonous paint: Who is to blame for this mess? And how can companies avoid becoming the next Mattel?

The blame game

Responses about who to blame have been fast and furious. The US and Europe have complained about lax Chinese regulations, low quality assurance (QA) measurements and ruthless Chinese manufacturers who increase their profit margins at the expense of their customers' health. Protective tariffs and bans of products made-in-China have been called for until it would be assured that Western kids can safely handle their toys again without having to wear protective gloves and safety goggles.

China has struck back saying that Western governments, corporations and media are engaging in blatant trade protectionism. US pacemakers and soybeans were rejected by Chinese customs as they did not meet Chinese standards.

The blame game is in full swing. But amidst all this finger-pointing, a pattern of actual facts remains clear :

One fact is that many Chinese manufacturers cut corners: by using lower-quality materials, by running cheaper production processes and by violating pollution laws. Their actions might not be intentional (e.g. suppliers are often not up to date with the latest product standards or lack sufficient resources) yet the outcome is the same. However, the driving force behind this are, in fact, multinational corporations who have been aggressively pushing down prices. According to the Wall Street Journal, discount retail chains in the US have forced down the price of clothing imports by 25% since 1995. With shrinking margins, suppliers struggle

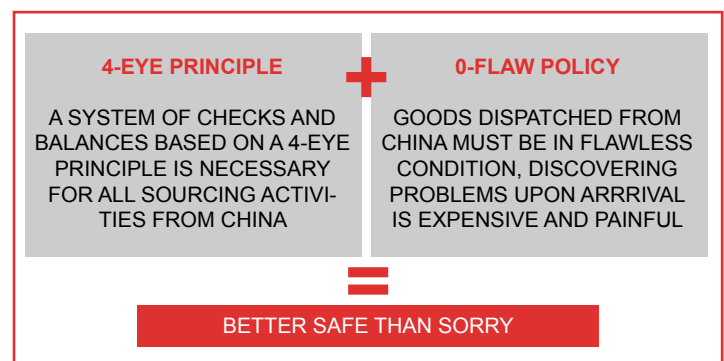
to make ends meet; a fact likely to result in this so-called "quality fade". So despite the obvious non-compliance of many suppliers in China, it should be clear that the final responsibility for flawless products lies with the international buyers - in their own interest.

How not to be the next Mattel

As expected, China and the US have quickly launched a plethora of campaigns, initiatives and regulations, from grass-roots to highly official, trying to keep the product safety and quality issue from spinning out of control. But are these measurements really of any help to a company involved in China business now? Instead of relying on government actions, companies have to develop a pro-active approach to secure their product quality in an efficient and sustainable manner.

Being on the same page with your China supplier in regards to quality standards can be the headstart to securing product quality. This can be obtained by meetings and training sessions where quality goals are mutually agreed upon and QA measurements are explained and put into place. After all, sourcing relationships work best when both parties benefit from them.

Yet, despite all goodwill and relationship building, control is still the one and only conditio sine qua non. This especially holds true for China where one of the most basic principles in business is (pre-) caution. A system of independent, random and comprehensive checks and balances is most



important for a successful China engagement. All actions and processes should be double-checked by a trustworthy second pair of eyes. If the container content is only checked upon arrival, companies might be in for a big surprise and quite possibly lose precious time and money. Therefore, all QA measurements already have to take place in China. As the saying goes, better be safe than sorry.

Fiducia's four-phased approach highlights key necessities of QA tools of international companies in China. These prerequisites for high-quality products and procedures include:

CONTENT

Made in China: Better safe than sorry

Management Consulting in China

HR Headaches: The art of keeping Chinese staff (happy)

China Sourcing Fairs: Streamline your supply chain

Management Consulting in China

FIDUCIA'S NEW CHINA CONSULTING MANAGER, STEFAN KRACHT, HIGHLIGHTS THE IMPORTANCE OF RELIABLE DATA – AND THE CHALLENGES INVOLVED.

China Focus (CF): First of all, congratulations on Fiducia's 25th anniversary! How does it feel to work for a company that has been doing business in China and Hong Kong for such a long time?

Stefan Kracht (SK):

Thank you but I cannot take much credit having joined only in 2005. My parents' entrepreneurialism combined with the Fiducia team's energy made 25 years of success possible. That combination is great to work with, as many of our employees have been with us for over ten years and possess a vast amount of expertise and client relationships. I count on my China business experience to add to this valuable base that Fiducia has accumulated as a company.

CF: Why did you join Fiducia?

SK: In 2004 my parents realised that the flexible, opportunistic style of earlier years was unable to accommodate clients' demands and the growing size of our business. So they sought to professionalise service execution and client handling, an approach I personally identified with strongly and where I felt I could add value. This view was shared by my parents based on my educational background and experience having worked for over eight years in strategy consulting and trading companies in Europe and China and as an entrepreneur in Shanghai. Therefore my main focus in the first two years at Fiducia was to restructure our organisation and strengthen our company culture. At the same time, we combine these improvements with traditional values and the past entrepreneurial flexibility ("know the new but preserve the old"), which has reinforced our team's sense of pride of being part of Fiducia and which is showing strong results.

CF: What specific services does Fiducia's China Consulting (CC) department offer?

SK: We provide management consulting services for international companies operating in China or planning to enter the Chinese market.

These services include but are not restricted to Sourcing Strategies; Growth and Entry Strategies; Market Maps (Industry/Competitor Analyses); Location, Supplier, Distributor and Partner Analyses; Product/Customer Segmentation, and Company Acquisition Searches. Clients turn to us when they require experienced, dedicated support for information or



PHASE I: PRODUCT SEARCH & NEGOTIATIONS



PHASE II: CONTRACT



PHASE III: PRODUCTION



PHASE IV: SHIPMENT & DOCUMENTATION



CUSTOMER SATISFACTION

PHASE I: PRODUCT SEARCH & NEGOTIATIONS

- 1) Clarify requirements with respect to design, function, product liability, safety laws
- 2) "Seek truth from fact": Clarify involvement and scope of manufacturers, suppliers and sub-contractors.
- 3) Cross-check price information independently
- 4) Use samples to check for possible sources of defect
- 5) Conduct factory audit, check licenses
- 6) Approve the manufacturer – not the supplier

PHASE II: CONTRACT

- 1) Secure the agreed terms
- 2) Include detailed order specifics incl. packaging and labelling
- 3) Specify manufacturer's quality assurance commitments
- 4) Consider IP issues (ownership, licensing, protective measures, remedies) and their impact
- 5) Install anti-bribery clause
- 6) Incentivise supplier through payment terms
- 7) Include warranties
- 8) Don't forget dispute settlement paragraph

PHASE III: PRODUCTION

- 1) Execute quality assurance (QA) programmes with suppliers, manufacturers and approved sub-contractors; include training and written QA guidelines
- 2) Monitor compliance of factory's QA programmes
- 3) Conduct ongoing quality control (QC) for all product features, design, functions
- 4) Packaging, certification tags, labelling, user manual etc are as important as the actual product.
- 5) Have QC capacity on location or outsource same
- 6) Sub-contract QC for products with special requirements or high risk products
- 7) Let products be analysed by approved laboratories
- 8) Conduct unexpected random checks

PHASE IV: SHIPMENT & DOCUMENTATION

- 1) Supervise container loading and shipping
- 2) Liaise shipment with shipping line or logistics provider
- 3) Check supplier's shipping documents
- 4) Have payments approved and effected by separate people
- 6) Ensure correct product classification for customs purposes

Pro-active protection

It isn't really important who eventually gets the blame for the tainted toys. What is important is for companies to pro-actively make sure they have proper QA instruments in place and their supplier relationships allow for a mutually beneficial cooperation. In the long run this will prove much more valuable than squeezing some extra pennys out of the Chinese suppliers. Because in the end, it really is that simple: good quality has its price.

CHINA'S ECONOMIC REGIONS



advice they are unable or do not have the time, resources or expertise to obtain.

CF: What is your impression after the first 100 days as head of the China Consulting department?

SK: My first impression was that I took over a strong, diverse team with an established methodology and a high quality level of output; all of which is reflected in the high client retention rate. Yet we are facing increasing competition as the Chinese consulting market becomes more mature and comparable to Western countries. The entry of well-known Western and local players has resulted in increased competitiveness in serving clients as well as finding and retaining consulting staff. Based on my personal experience in consulting and in dealing with opportunities and challenges in China, my aim is to strengthen our team by further developing our industry focus and methodology – which promises to be exciting and probably not comparable to the typical “Western” business practice.

CF: What is different about advising companies in China?

SK: First of all, there is the sheer size of Chinese markets which are often very large (both geographically and economically) yet fragmented in terms of regions and sectors. As extensive research has shown, it makes sense to divide China into economic regions based on factors such as population density, GDP, income per capita, foreign direct investment and infrastructure.

Secondly, as information that goes beyond plain macro data is generally scarce, outdated and unreliable, our methodology leans toward a qualitative approach, for instance through direct, personal interviews with industry experts and our clients’ competitors. We are able to carry out these interviews not only based on our past project track record but also due to the fact that Fiducia actually implements many clients’ plans including their back-office work.

“I am proud to be a part of this team.”

Stefan Kracht, Manager China Consulting, Fiducia

CF: Isn’t this very resource intensive and time consuming in a huge country such as China?

SK: Yes it is. But only through this hands-on approach, by actually travelling all over China to conduct face-to-face interviews, can we generate data our clients can rely on to make good decisions. We are able to give strong advice because we have visited the factories and talked to the people on the ground. For example, if our consultants have seen with their own eyes that a certain manufacturer can build a

certain amount of products per day and can actually generate a defined amount of revenue or profit, this is powerful information for a client, which makes the frequent travelling to remote places in China worth the effort.

CF: Are you always able to get the information your clients require?

SK: It can be difficult at times to get relevant and precise data, even through our direct approach. In such cases, reading between the lines, understanding the interviewed person’s cultural background and triangulating data from multiple sources helps us to test our hypothesis and to understand the full picture. For instance, we send out mixed teams, composed of Chinese and Western consultants, which enables us to look at situations from different angles in terms of conceptual understanding and language. At the same time, we adhere to strict ethical guidelines so as not to gain false information or to compromise our clients’ integrity and plans.

CF: In your opinion, what factors are crucial to Fiducia’s continued success over the next 25 years?

SK: We at Fiducia want to be the preferred independent professional service provider for international companies in China and Hong Kong. To achieve this ambitious goal all Fiducia employees have to be committed to and professional in consistently delivering the high-quality service our clients value. On the other hand, it is critical to keep our employees happy and to make sure they are proud to be on board. I certainly am proud to be part of this team.

HR Headaches: The art of keeping Chinese staff (happy)

THE OUTCOME OF A STUDY AMONGST 600 COMPANIES IN ASIA NAMES STAFFING TROUBLE AS THE NUMBER ONE CONCERN - HERE IS WHAT STAFF REALLY WANT.

Staffing issues remain a headache for many HR managers in China, according to a study recently conducted by the Economist Intelligence Unit. The decisive factor why local potentials turn down job offers is not necessarily the demand for higher wages or more vacation time. If companies look at some of the secondary factors that keep Chinese workers from leaving their jobs, they might end up with some new and possibly more successful retention methods:

Training and a clear career path

Employees are less likely to leave a company if they feel that it is a place where they can grow and add value to their careers. This could be said about most employees anywhere in the world, but in China, the ideas of career and personal growth are often not separated. Learning and training are considered critical factors for staff as education is highly valued in Chinese society. This is a fact that companies which are looking to localise should take advantage of. The McKinsey Global Institute estimates that China will need 75,000 business leaders in the next ten years with currently about 3,000 to 5,000 leaders available. So instead of fighting over the existing pool, the development of “internal” talent may be a more promising approach. Local employees are already in China and they speak the language. Most importantly, they are willing to learn – according to a survey by the China Market Research Group, 90% of Chinese youth between the age of 18 and 28 look for continuing education.

41% of those same people see continuing education as the way to raise their salary and obtain their career goals. More often than not, simple practical training such as budget planning for department managers, presentation seminars for sales staff or assessment training for HR personnel will help update and improve employees' skill sets - and their willingness to stay. A successful example is Cisco System's Shanghai office which runs a "management kindergarten class" for all young managers teaching them basic concepts such as how to handle key decisions.

New challenges and travel

Another way to retain employees is to provide new opportunities. One way to gauge this is by asking them at their quarterly or annual review where they see themselves going in the company, what other departments in the company they wish to experience working in. IBM has another method to see which of their employees would be ideal for which department. It uses "Personal Business Commitment (PBC)" which measures how employees meet company and department targets. An "Individual Development Plan (IDP)" contains details of training an employee feels he needs to reach these targets. If an employee has been with the company for at least two years and met their goals for IDP and PBC, they cannot be refused a transfer to another part of the company without a valid reason. That opens up a whole new window of possibilities for many employees and gives them a much larger incentive to stay with a company.

Giving local staff the chance to go abroad e.g. to a company's head office for training can be a positive challenge, especially when international travel is difficult for many Chinese. It also gives them a chance to work in an international context and gain a new perspective. This can allow for easier communication between the head office and this staff at a later stage. It will also help them develop a range of management skills they may be lacking in their current position in China. Companies such as L'Oreal and Starwood Hotels & Resorts have employed this method in China with great success.

Local networks and care

It cannot be said often enough: when doing business in China, relationships and local networks are key. That means when hiring a Shanghainese employee, one is not only benefiting from that person's skills, but also tapping into the relationships he or she has with family, friends and colleagues from previous jobs - in Shanghai. Employees are more willing to stay with a company when they work in their home city or area where they have their social network and can have the most impact. This doesn't conflict with letting staff travel - if you are allowed the chance to return home. Since there is no strong social safety net in China, many elderly people rely on their children to care for them. As this is still considered a duty by the children in Chinese society, it certainly restricts mobility. Employees might be happier to stay if their company's location allows them to fulfill their career aspirations while still living up to their filial duties. Local advantage can also be created by making sure that it is easy for employees to get to the office - either through a central office location or through transportation support such as corporate shuttle buses or a pick-up service for managerial positions.

Personal attention by superiors and the often-quoted "open door policy" can contribute significantly to job loyalty and

retention. Caring for employees can also mean extending benefits to their children or elderly relatives - offering education plans or family medical care are other incentives that can be used to keep your employees from becoming job hoppers.

Find and bind

Employee retention is still the number one issue of employers in China and a tough issue to tackle successfully. The main challenge besides hiring a promising talent is making sure they will stay. Looking beyond primary considerations such as salary or annual leave might help strengthen their loyalty to the company to an unexpected extent.

China Sourcing Fairs: Streamline your supply chain

FIDUCIA'S BUSINESS DEVELOPMENT MANAGER, THADDAEUS MUELLER WILL TALK ABOUT CHINA SOURCING OPTIONS AT GLOBAL SOURCES' FAIRS.



With the tradeshow season beginning in October, the possibilities of informing oneself about China manufacturers and products are endless. An option we recommend is to attend the China Sourcing Fairs organised by Global Sources in Hong Kong's AsiaWorld-Expo (e.g. Electronics & Components: October 12-15, 2007). Here, a large number of suppliers from a huge variety of industries is combined with seminars on business-related topics. Mr. Thaddaeus Mueller will give insights into various strategic considerations when setting up operations in Hong Kong and mainland China and tackle concerns buying operations are currently dealing with. He will also present practical tips and a roadmap to setting up operations.

For previous issues and newsletter subscription: www.fiducia-china.com
Publisher: Fiducia Management Consultants
Editor & contact for press and article reprints: Yuki Kobler; contact@fiducia-china.com

All liabilities excluded. This newsletter is based on information obtained from sources (government, business associates, companies, publications, etc.) we believe to be reliable. However, Fiducia Management Consultants does not take any responsibility as to its accuracy, completeness or correctness. Copyright © 2007 Fiducia Ltd. All rights reserved. Protected by copyright laws.

Beijing Office: Unit 0603, Landmark Tower2, 8 North Dongsanhuan Road, Chaoyang District, Beijing, 100004, China, Tel: +86-10-6590-6108, Fax: +86-10-6590-6109

Hong Kong Office: 12/F Fortis Bank Tower, 77 Gloucester Road, Hong Kong, Tel: +852-2523-2171, Fax: +852-2810-4494

Shanghai Office: Suite 1908, Ciro's Plaza, No. 388 Nanjing Road (W), Shanghai, 200003, China, Tel: +86-21-6327-9118 Fax: +86-21-6327-9228

Shenzhen Office: Rm.1503, Middle Fujing Building, Fuzhong Road, Futian District, Shenzhen, 518026, China, Tel: +86-755-8329-2303, Fax: +86-755-8329-0821

Fiducia Management Consultants is a member of:



www.agn.org



www.aims-international.net



www.cdiglobal.com