****

9B18M070

Skutis: Negotiating Production in China

Stephen Grainger wrote this case solely to provide material for class discussion. The author does not intend to illustrate either effective or ineffective handling of a managerial situation. The author may have disguised certain names and other identifying information to protect confidentiality.

This publication may not be transmitted, photocopied, digitized, or otherwise reproduced in any form or by any means without the permission of the copyright holder. Reproduction of this material is not covered under authorization by any reproduction rights organization. To order copies or request permission to reproduce materials, contact Ivey Publishing, Ivey Business School, Western University, London, Ontario, Canada, N6G 0N1; (t) 519.661.3208; (e) cases@ivey.ca; www.iveycases.com.

Copyright © 2018, Ivey Business School Foundation Version: 2018-05-01

In August 2015, while studying law in Singapore, Henry Jurgens came up with the idea for his first scooter when he needed a simple and economical mode of transport to get from his apartment to university. Jurgens’ simple scooter was a personalized transport vehicle that could be easily stored. The small electric engine offered convenience for business and university travel, especially in environments where four-wheel vehicle traffic was congested.

Jurgens, who was Norwegian, soon partnered with Mike Yeo, who was from Singapore, to begin developing the product for sale in Southeast Asia. The two partners registered and incorporated Skutis Corporation Pte Ltd (Skutis) within only five days. The Skutis e-scooter emitted no fumes or noise and featured a quick folding design for easy storage. Its normal design consisted of one front and one rear wheel, but designs with two wheels in front or rear were also available. The Skutis normally travelled between 20 and 50 kilometres per hour, although some designs could travel up to 80 kilometres per hour. The various models of the Skutis weighed 7–40 kilograms and could carry 100–200 kilograms of weight. Some models came equipped with two seats.[[1]](#footnote-1)

Being low on financial resources, the two partners set up a simple functional office, repair shop, and showroom. They stored the Skutis e-scooters that were ready for sale in a nearby basement space. As new entrants in the industry, they felt confident that their combined study skills (law and business) would help them design and produce a more durable and dynamic scooter than those currently available.

By April 2017, Skutis had already encountered major difficulties dealing with a Chinese manufacturer of its products. After 20 months of experience in the market, the two entrepreneurs were planning their company’s strategy for the future. Having experienced the lows and highs of the Chinese production market, they were searching for ways to make their business more profitable and develop a long-term trustworthy relationship with a reliable manufacturer who would produce their designs.

Skutis History

The concept of a Skutis type of scooter originated more than 120 years ago in Europe, when designers wanted to create a motorized scooter for letter carriers to use in their daily deliveries. The original scooter had a metal frame and a small gasoline-powered engine. The early models were too expensive, the batteries too heavy, and the designs too cumbersome. As a result, sales remained low into the next century, as the products developed. In the early 2000s, the technology advanced considerably. Scooter structures became lighter and stronger, as batteries became smaller and more powerful, which greatly improved the product’s viability. The new scooters were built from a hybrid carbon fibre or aluminium and ran on a rechargeable lithium battery. The Skutis e-scooter provided endurance, efficiency, portability, and marketability.

Jurgens and Yeo were excited by the evolution of scooter technology and started to work on their own designs. To turn their dream into reality, Jurgens realized that the company would need to find a producer capable of manufacturing their Skutis designs. In their initial research of scooter manufacturers, they discovered that more than 100 different models of scooters were already in mass production around the world. Most manufacturing was being done in China, with smaller, but significant, amounts being manufactured in the United States, Israel, and South Korea. The high volumes made it difficult to compare the quality, models, and brands from the many manufacturers, or even differentiate between suppliers that were manufacturing entirely or only assembling scooters.

Jurgens and Yeo decided on Singapore and Indonesia as their initial target markets. Their search for a manufacturer led them to China. Jurgens did not speak Mandarin, so Yeo acted as translator. Having a trustworthy friend and business partner as translator allowed Jurgens to interact first-hand with the manufacturers they met. Because of their limited experience in the Chinese environment, they conducted research and due diligence on potential manufacturing partners in preparation for their trip.

Jurgens had limited business experience. However, growing up in Germany and studying in Asia had helped make him technologically sound by age 30. He was a clear and confident communicator. Jurgens had fully financed the setup of the company, and was therefore the sole company owner of Skutis. As a result, Jurgens had the final say on all business decisions. Yeo was his business partner, sounding board, and advisor on the Asian perspective. Jurgens accepted credit for the successes and blame for failures of his first ever company, but felt considerable pressure from customers, friends, family, and business partners.

Both Jurgens and Yeo were confident that their new design ideas were marketable and that their product was an improvement over existing scooters in terms of portability and performance. Having completed some new designs, their focus turned to finding a suitable manufacturer to produce the products, and how long it would take to deliver the first test order. As part of their first trip to China to meet several manufacturers, they hoped to visit operation sites and learn about the Chinese business culture.

When Jurgens and Yeo first arrived in China, they were surprised to find a basic level of development and quality of manufacturing, compared to their backgrounds in dynamic and technologically advanced countries of Germany and Singapore. However, although the Chinese manufacturers were unsophisticated, they were young and eager to improve. Mainland Chinese companies were keenly studying western manufacturing methods and were open to outside influence in their development. Jurgens and Yeo were impressed, however, with how far China had come in the development of electric vehicles, modern city skyscrapers, new roads, and constantly improving pedestrian walkways. They both agreed that design and innovation appeared to be an area in which China still struggled, as Jurgens confirmed:

We found in China that producers are lacking design, innovation, and creativity skills so they appreciated working with foreign experts as they could benefit from this influence in their production. To build relationships, we didn’t mind helping them improve their existing products providing they didn’t put our brand on the product. From a larger perspective, it appeared they would benefit from our ideas and we would benefit from them being reliable in terms of production schedules, stable supply, and deadlines. This period of research I found very stressful.

Their online search for potential Skutis manufacturers led them to the Chinese company Technology Co. Ltd. (TNE), a manufacturer that was producing a basic model of scooters in Shenzhen. In February 2016, Jurgens and Yeo contacted TNE using the Chinese e-commerce platform Alibaba, after completing a considerable amount of research on their potential supplier. Initially, they communicated with TNE’s English-speaking overseas sales manager Lily Lim. Despite the vastly different business environments and backgrounds of the two parties, they commenced the communication process with the aim to develop a working relationship. Although Lim seemed to be TNE’s only English-speaking employee, her competent level of English allowed Jurgens and Yeo to communicate with her easily, compared to representatives of other companies who spoke only Mandarin.

After Jurgens and Yeo contacted, considered, and communicated with several potential manufacturers, they focused on working with TNE, whose product quality seemed to match their expectations. Even though they were not able to visit TNE on their first visit to China, they believed it could meet their needs.

They emailed and spoke to Lim many times over the next three months regarding the type of prototype Skutis wanted TNE to produce, and placed their first order for test samples to be delivered to Singapore by the end of May 2016. The first order was delivered on time and in good condition. Apart from a few minor issues with specification variations on the test products, Jurgens and Yeo were pleased with TNE’s work, and they were confident that the minor problems could be resolved before placing their next order. A few months later, in October 2016, Jurgens ordered eight new prototype Skutis to be delivered to their new office in Indonesia, two additional Skutis to be shipped to a potential new business partner in Hamburg, Germany, for inspection, and another four Skutis to be shipped to Singapore. However, the second sample of prototype Skutis from TNE began showing the first problems with quality. Jurgens described his team’s frustrations:

Unfortunately, at this time we realized the original minor design and production problems being experienced by TNE were much bigger than we initially perceived. We determined that the quality of the product they provided varied significantly from our specifications and we believed there were obvious errors that were exposed, as we were using more exact measuring technology. We had expected the second samples to improve and now we discovered other problems with the batteries. Moreover, TNE’s so-called “stainless screws” started to rust within a few days in the tropical environment of Singapore and Indonesia.

Several days later, the Skutis team discovered that the battery life was much shorter than expected. Collective variations from the exact design specifications were up to 30 per cent lower. The estimated speed of the Skutis was also approximately 30 per cent lower than expected. The team determined that the Skutis prototypes could only safely transport 120 kilograms, instead of the 200 kilograms claimed by TNE. Other problems included tires that would easily go flat, motors that broke down, and malfunction in humid climates.

TNE also failed to honour its product warranty. When something went wrong with a product, TNE would simply claim it was someone else’s fault. For example, when the Skutis team tested the battery chargers of the Singapore shipment and found that none of the four batteries were charging, TNE claimed that the malfunction must have occurred during shipping. To broaden the scope of his inspections, Jurgens loaned the Skutis prototypes to cycling friends in Germany for them to test in Hamburg. He wanted to see how the Skutis responded under cooler German conditions. Faults in manufacturing were found during the German testing.

Jurgens also noted that Lim’s support and polite manner was dissipating over time. She failed to reply to some emails and would argue about warranty claims. Lim stopped helping solve problems and became reluctant to offer any support. By the middle of November 2016, facing manufacturing problems and a deteriorating relationship with Lim, Jurgens was seriously considering ending his business relationship with TNE.

He was not sure if the problems were with the company or if personal issues were affecting Lim’s customer service. To determine the cause of the issues, Jurgens asked his Mandarin-speaking friends in Hamburg to contact the chief executive officer of TNE directly. This plan became a critical step in the process. The Hamburg contacts confirmed that Lim was, in fact, the only person at TNE who spoke English. They discovered that she had apparently taken advantage of her language ability to create her own sub-contracting company within TNE and control all communication from Skutis, blocking all contact from Skutis to her superiors. All promises she had made to Jurgens were never confirmed by TNE. In fact, the company’s directors were unaware that Lim had been dealing with Skutis since February 2016.

Jurgens and Yeo had still not been able to visit TNE in person, although Lim promised that she would arrange a visit in January 2017. The timing would allow Jurgens and Yeo to get business visas. Lim promised that her staff would provide training for the maintenance and repair of the Skutis during the visit. Lim committed to delivering 100 Skutis by February 2017, which was a critical part of the Skutis strategic plan for 2017 and beyond. Lim also promised that TNE would be able to deliver smaller models and provide support for Jurgens’s marketing initiatives.

Lim’s promises were communicated through email, and Jurgens expected them to be honoured. He had assisted TNE’s intellectual property (IP) design team with ideas for getting the product into Singapore and Indonesia. In retrospect, he felt that he should have been cautious in exchanging potential IP information before developing a stronger trusting relationship with the management team at TNE.

Jurgens later recalled his potential errors:

I had consciously helped TNE with their design and taken this risk to win TNE’s trust and to increase my company’s value for them. As a small start-up business, at that time, I was in a very weak negotiation position and needed to use every tool we had to make TNE pay attention to our requirements.

One example of his assistance was helping TNE design a carrier box to sit on the back of the Skutis. In return, TNE agreed that the cost would be only an extra US$10[[2]](#footnote-2) per unit. However, TNE soon changed their position and began charging $50 per unit. Jurgens felt cheated and worried that TNE was “still using some of my other IP ideas, as well.”

Sudden Change in Conditions

In December 2016, TNE’s overseas manager Lim informed Jurgens that the delivery of the 100 units and the training initiatives that had been confirmed would no longer be possible. This was a disastrous change for Skutis. All of the company’s sales for 2017 were based on the delivery of the 100 scooters. In desperation, Jurgens contacted TNE’s general customer service hotline by email and received a reply informing him that they had no knowledge of his company, his current order, or any previous order of 14 Skutis, which had already been received. In the reply, the TNE representative informed Jurgens that TNE had a policy of not accepting orders of less than 50 products. Therefore, the previous test sample orders were in violation of company policy, and the orders would be investigated. Shortly after that, Jurgens was informed that Lim’s corrupt activities had been discovered and she had been demoted and transferred to another department.

Problems in Germany

In December 2016, Jurgens contacted a German marketing company called Beat-Up that he hoped would agree to work with Skutis. To improve the chance of working with Beat-Up, Jurgens asked Lim to provide a favourable reference for Skutis as a professional partner, based on a good relationship with TNE. However, the marketing company contacted Lim shortly after her demotion at TNE and she seized the opportunity to seek revenge for losing her position. Lim proceeded to write a defamatory reference via email to Beat-Up, claiming that Skutis was an unsuitable business partner. In her email, she described Skutis as unprofessional and claimed that TNE refused to work with the company.

Lim’s email generated a negative reaction from Beat-Up. The marketing company, which represented several high-profile international hip-hop music personalities, had expressed interest in having their music stars ride around on a Skutis for advertising and media campaigns. Jurgens and his contact in Hamburg had first met representatives from Beat-Up in October 2016, when they had established a great start to their relationship. The two companies were close to confirming a deal when they received the scathing reference from Lim.

Lim’s email to Beat-Up, one of her final emails as TNE’s overseas sales manager, claimed that Skutis had credit issues. She also claimed that TNE had rejected many requests for collaboration because working with Skutis would cause harm to TNE’s reputation.

At the time, Jurgens was not yet fully aware of Lim’s corrupt practices, so he was shocked to hear about Lim’s email to Beat-up from his contacts in Hamburg. All of Lim’s claims were untrue, of course, but it took some time to investigate the events and determine what led to her defamatory response. It was then that Jurgens learned of Lim’s adverse activities, which raised confusion among the entire Skutis team.

As a result of Lim’s negative email, Beat-Up withdrew its interest in working with Skutis. Jurgens summarized the events as follows:

It was not that they didn’t trust us anymore, but they were reluctant from then onwards to be involved with Skutis further or with such a questionable Chinese production company (TNE). They could not let their hip-hop stars be involved in such a scandal. So, it was a damaging email in terms of our future together moving forward. As everything looked positive moving forward with Beat Up, this email damaged our potential and damaged our goodwill. That was a catastrophe for our young company.

The timing of the breakdown in relationship with Lim and TNE was critical. Skutis had just developed a company website, hired a marketing manager, established a marketing program, and created a business plan for the year ahead. The preparations and planning for 2017 were almost complete. The end of a relationship with TNE and loss of a potential partnership with Beat-Up were both major setbacks. The company’s planning would have to be restarted.

The Skutis team members became very upset. They knew that TNE could produce the Skutis designs. In fact, TNE had already incorporated some Skutis design features into its own products, without permission or acknowledgement of the Skutis IP rights.

Lim’s scheme had been to create her own small business within TNE. She would charge Skutis one price but pay TNE a lower amount, keeping the difference as her profit. TNE directors were unaware and unable to check her communications with English-speaking customers. Lim’s actions created a serious problem for Skutis. The company would never receive the 100 skutis it ordered, and none of the training would be provided. By January 2017, Jurgens stopped all attempts to communicate or co-operate with TNE. However, he realized that Skutis still needed TNE’s assistance: “There was still the problem of dealing with the after-sales service that they needed to provide for the 14 Skutis we had already purchased from them.”

Communication with TNE became nearly impossible after that point. TNE refused to honour any requests by Skutis, including spare parts or service. When Jurgens requested several replacement tires, TNE responded that no orders for less than 50 tires would be considered.

Feeling at a loss, Jurgens enlisted the services of a Mandarin speaking lawyer from Singapore. In February 2017, the lawyer wrote several letters to two factories that TNE apparently operated in Shenzhen. However, the lawyer soon discovered that one of the two factories did not exist. He assumed that this second false address must have been used by Lim for her corrupt activities. TNE seemed to operate only from one factory, and the company’s representatives never replied to the lawyer’s letter. The lawyer then engaged a Chinese law firm in Shanghai to help with the matter, but Skutis continued to wait for any potential legal determination or compensation. Jurgens expressed his frustration:

We estimated we had wasted the value of $300,000. The reason was not that we had so many actual material damages, but a considerable amount of lost profit and reputation damage had resulted. The real damages of about $12,000 comprised of the cost of employees, websites, banners, etc. Because TNE had refused to create any written contract, our case had to be based upon the approximately 1,000 emails sent between us. We had to re-read all the emails to give the lawyers a summary of the situation, claims, promises, etc. Now, we are waiting for a reply from TNE to our second letter and if they fail to reply, then we can go to a Chinese judge and begin legal actions against them. It appears TNE doesn’t want to negotiate or get mediation, so it looks as if our only option would be to sue them. To achieve this, translation of a large number of the emails may be needed, and this alone could take a long time. Now, we are hoping they will reply to the second letter we have sent them from our Chinese law firm, and to negotiate a fair outcome; however, if that does not happen, I will have to decide what we want to do.

Skutis proceeded with its business plans by contacting “a much smaller and friendlier supplier who seemed honest, and who wanted to develop a long-term relationship with us.” Jurgens and Yeo visited the new supplier in March 2017 and were welcomed to stay on-site for an entire week. In contrast to TNE, the new manufacturer showed the Skutis team the production site, indicated some basic training techniques they were prepared to provide, and paid for all of Jurgens’s and Yeo’s accommodation and food expenses.

Although the reception by the new supplier was a completely opposite response to the TNE experience, Jurgens and Yeo wondered whether their company should proceed with a new attempt at manufacturing its products. Skutis had exhausted most of its investment funds by that time, but Jurgens had one last emergency fund worth $60,000 that he could access, if necessary. If Skutis were to proceed, the errors the company made in the TNE experience would have to be avoided. How would Skutis ensure that the negative experience would not be repeated? Were there other issues that needed to be addressed by the upcoming April 2017 strategic planning meeting?

Dr. Stephen Grainger is an International Business Adjunct at the University of Notre Dame, Fremantle, Australia

1. “Products,” Skutis, accessed February 5, 2018, www.skutis.co/product-category/skutis/. [↑](#footnote-ref-1)
2. All currency amounts are in US$ unless otherwise specified. [↑](#footnote-ref-2)