



HOW TO SOURCE FROM CHINA

A SIMPLE GUIDE



WELCOME

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Despite rising wages, foreign competition and other challenges, manufacturing in China continues to be the cheapest location for many Western retailers and manufacturers to source goods and parts. In fact, **China's share of total global manufacturing output was 25% in 2015.***

*Source: Deloitte, 2016, Global Manufacturing Competitiveness Index

THE CHINA ECONOMY



6.9%
GDP Annual Growth



US\$2,283 billion
Annual Export Value



40% of GDP
is attributed to
manufacturing



231 million
people work in the
manufacturing sector

*Sources:

Focus Economics, 2016; McKinsey, 2016; Statista, 2016

WHERE DO I **START?**

Once you have a particular product you would like to source, there are a few ways of finding the right supplier to make your product, depending on the level of risk and control that you are comfortable with.

SOURCING SERVICE PROVIDERS

Sourcing service providers can provide an end to end service, including supplier identification, price negotiation, production, quality management, logistics and so on. They could be the most costly way of engaging with a Chinese supplier, though a good one may be able to take a lot of the hassle out of the process for you.

COMMISSION-BASED CHINA SOURCING AGENT

You can also engage a commission-based China sourcing agent who can help identify reputable suppliers and facilitate communication. These agents charge a percentage of the purchase price. Although they are not often actively involved in managing production and quality, they might be able to guide you along the process until you feel confident to do it yourself.

SOURCING ONLINE

If you would like to venture out on your own, carrying out your research for suppliers in China on the Internet could be a really cost effective way to do the initial research - via search engines like Alibaba, Global Sources and Made-in-China.com. However, be aware that 'verified' suppliers on these sites may only mean that the companies exist, and not that the site has validated their reputation, production capability, or quality (for example, a gold member at Alibaba is a paid-for status).

TRADE SHOWS

Trade shows both in China and in the UK, for example the Brands of China area at **Autumn Fair**, are the most tried and tested way to find Chinese business partners. You are able to research the exhibiting suppliers before the show, have the opportunity to talk to the potential suppliers face to face on the day and explain your specific needs and requirements. This is in addition to gaining a general understanding of their offering, capacity, and other key information needed to make the initial selection of the suppliers you would like to take to the next stage. Some of the exhibitors are also trading companies who can be a practical alternative to buying direct from manufacturers if you are only looking at buying smaller quantities.

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WHAT ARE THE KEY ELEMENTS TO CONSIDER?

NEGOTIATION

Everything is negotiable! A good understanding of factors regarding manufacturing such as the level of customisation required from an 'off-the-shelf' product or component, minimum order quantity (MOQ) and set-up costs (e.g. tooling) can help you in the negotiation process.

Other factors to consider is which incoterms (International Commercial Terms) the contract is based on:

- **EX-works:** Means that you are responsible for all logistics from the factory door to the final destination.
- **FOB (Free On Board):** It saves a lot of hassle and cost if you ask your supplier for an FOB price rather than Ex-works. The former includes the cost of transport to port, customs clearance and ship loading, and some extra paperwork and fees.
- **CIF (Cost, Insurance and Freight):** Price includes shipping cost in addition to FOB.
- **DDU or DAP (Delivered Duty Unpaid or Delivered At Place):** Price includes any costs associated with taking the goods from destination port to final destination, such as paperwork, customs clearance, and last mile trucking.

PROTECTING YOUR IP

It is highly recommended to protect your product branding and design if you are looking to manufacture in China.

There are a few things you may want to look into:

- A robust contract with the Chinese supplier, including non-disclosure, non-use and non-circumvention clauses.
- Have the contract written in Chinese and enforceable in China, this is absolutely essential.
- Prohibit subcontracting. If this is not possible, try to minimise the risk by limiting the number of subcontractors used and ensure the supplier is liable for the subcontractor.
- Look to cover yourself with a Patent – one which covers China, not just in the UK or EU.
- Seek legal advice.

MAKING PAYMENT

Do take the fluctuations of the purchase price currency into consideration, as the value of the currency may vary from the point that you agree the price and the point when you need to pay, especially when sterling is particularly weak due to the risk associated with Brexit.

Negotiate payment terms with your supplier too. It is standard to be asked to pay pro-forma or a percent deposit when the sample is approved and before production proceeds, with the remainder payable when the goods are handed over at port or delivered.

There are a number of ways to pay but Telegraphic Transfer (T/T), i.e. 'Wire transfer' is the most common payment method.



MANAGING QUALITY

Making sure you are going to get what you think you have ordered requires detailed management.

There are a few tools you can consider:

- **Write a detailed specification**, including measurements, material, graphics and logo. Use denoted pictures and simple concise wording, leaving no room for interpretation. Quality inspection criteria should also be agreed in this document - what kind of defect is minor, major or unacceptable and at what level and quantity.
- Ask for a **sign-off sample** before any tooling commences. Ensure that the factory and the supplier (sometimes suppliers have multiple factories) have an identical copy so that they can be referred to during production. However, some elements of the sample may not be fully accurate due to various reasons – for example they may not be able to give you the exact colour for such a small run. If this is the case, make sure you sign it off noting the details that would need to be changed for full production.
- Ask for a **pre-production sample** before the full production quantity is approved. This is a sample that would be made using the production tooling and material so it should be representative of final output. If something critical needs to be changed at this stage, it would still be cheaper to change it now rather than having to make a compromise or scrap the entire production.

- Ask for a **few samples from production** - compare it with the previous samples and ensure it is what you are expecting.
- **Inspecting final production** - following pre-agreed criteria, the factory can provide you with pictures of final output. Inspection can also be completed by the sourcing agent or a third party independent inspection company, such as Intertek Testing Services, SGS and Bureau Veritas. Based on the report and samples showing varying degrees of defects, evaluate if you are happy to give the supplier permission to ship.

LOGISTICS

Generally speaking, there are two ways to ship the goods over to the UK; by air or sea. The process of air and sea freight is similar but shipping by air is a bit simpler, much faster and far more expensive.

Sea freight is the most economical way of sending a large shipment of goods. Be sure to shop around to find the best freight forwarder as the cost from one can be as much as 50% more expensive than the other. Do your homework on paperwork such as Bill of Lading to ensure goods can be cleared and transported without delay.

ETHICAL SOURCING

Most reputable factories in China would have been audited against the ethical trading codes, for instance the Ethical Trading Initiative (ETI). The factory is expected to be audited regularly and demonstrate that they maintain their ethical standards and continuous improvements in areas such as limited working hours, fairly paid wages and health and safety requirements. These audits are carried out by third party auditing companies. Ask your supplier to provide you with the latest audit report and check if their practice is aligned with your ethical stance.

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ARE THERE ANY **CULTURAL** CONSIDERATIONS IN DEALING WITH **CHINESE SUPPLIERS?**

CHINESE NEW YEAR

Chinese New Year (CNY) is renowned for causing importers across the world a lot of headaches. As Chinese use the Luna calendar for their traditional festivals, the date of CNY is different every year, but it frequently falls between mid-January and the end of February. Workers who normally travel thousands of miles to work in a place that is far away from their home town can go home and spend their time with their families. In order to make this happen, factories can be closed for up to four weeks, allowing the workers to take almost all their annual leave in one go.

The net effects of CNY:

- The production schedule is extremely busy leading up to the break.
- The quality of production may take a hit during this busy time, due to staff working overtime and rushed production.
- Domestic transport and international shipping from China is extremely busy.
- Limited communication during time of shut down.
- Large numbers of workers may decide to stay behind or change jobs after the break, which causes capacity issues after the shut down period.

It is therefore wise to plan your development, production and shipping accordingly, so that it does not cause any unnecessary delays for you.



BUILDING RELATIONSHIPS

When doing business in any foreign country, it is wise to learn about the culture beforehand. Learn the appropriate etiquette and a few frequently used Chinese words before conducting business in China, as this will be very useful. Family, trust, and respect are deeply ingrained in Chinese culture. Understanding this and keeping it in mind during all interactions will give you an edge in dealing with Chinese suppliers.

Some basic business etiquette to give you a good head start:

- Chinese names place the surname before the first name. In formal engagements, do not address someone by their first name unless you are invited to do so.
- Corporate attire is smart and conservative. Men should wear plain suits with understated ties, while women should avoid wearing blouses or dresses that have a low cut neckline.
- Punctuality is a very important factor in China. Being late shows disrespect and will dramatically impact your credibility and likelihood of earning the trust of others. Regardless of your punctuality, do not be surprised if you are kept waiting for a long time, remember to wait patiently, do not leave or get frustrated.
- Chinese society is very hierarchical. The most senior person would be expected to enter the room or sit down at the meeting or dinner table first.
- In China, age is a good indication of seniority within an organisation, which is always worth bearing in mind when negotiating and making sure you are speaking to a decision maker.
- Ensure you take business cards with you and have plenty to hand around. When you give or receive them, use both hands and bow down a little at the same time. Take a second to read the card before putting it in your pocket, this shows respect and a level of interest. In addition, make sure your business card shows your position in the company and if you can, print Chinese translations on your cards too.
- Chinese people love to negotiate and the negotiation can be a lengthy process. Be patient as deadlines are rarely met, you need to factor delays into your critical paths.
- The Chinese are welcoming hosts, so accept their invitations with gratitude. It is also expected that you will reciprocate by hosting them at the end of your visit.
- Dining and drinking forms a huge part of the Chinese business culture. There is a Chinese saying 'To do business, be a friend first'. You are expected to be respected and trusted as a friend before you can be a business partner.
- Finally, don't tip at restaurants as this is considered insulting in the Chinese culture.

Although China is a long standing market for Western businesses to source from, due to differences in culture, language and infrastructure, it also presents its own challenges. We hope we have provided some useful advice that will help to make the process of sourcing from China much easier and as successful as possible.

Disclaimer

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