

# Business model for international sourcing: Case China

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## ABSTRACT

The purpose of this study is to address the significance of the international sourcing intermediaries in relation to western SME's internationalization process. Therefore this paper sets out to review and assess underlying potential for a supplier sourcing company that operates between the growing market of Chinese quality suppliers and the Finnish sales- and manufacturing companies.

The international sourcing (IS) companies are often small businesses that require years of networking. Therefore this study should determine how a new company could start up within this industry and what kind of business model should be used. The objectives of this research project derive from this setting; this research should determine answers to the following research questions: *1) What factors have an influence (driving forces) on using international sourcing? 2) What kind of business model could be derived from these factors to seize the IS opportunity? 3) What are the critical foreign supplier characteristics for internationalizing SME's?*

This paper establishes a theoretical background based on the above mentioned research objectives by reviewing a wide variety of literature from the fields of entrepreneurship, supplier sourcing, internationalization, business models, business opportunities, social capital, networking, and Chinese business environment. Also, the prevailing attitudes and experiences of the Finnish small and medium sized companies towards foreign suppliers and trade intermediaries were examined by conducting a questionnaire survey.

The research results suggest that an untapped IS opportunity exists within this market in the form of new necessities, trends and gaps. These opportunities thrive from the driving forces of the IS market, which include globalization and global competition, SME's lack of resources for internationalization, as well as the emergence of IS and the trend of IS becoming more and more common. This study has thus determined that the IS company and the IS entrepreneur can indeed offer significant added value for the western SME's by sourcing the best Chinese suppliers. Also, it was determined that there are numerous obligatory features and processes for the IS company and the IS entrepreneur, and they are accounted for in this paper by presenting a business model for the IS company.

## TIIVISTELMÄ

Tämän tutkimuksen tarkoitus on selvittää kansainvälisen hankinnan välikäsinä toimivien yhtiöiden merkityksellisyttä länsimaalaisten pk-yritysten kansainvälistymisessä. Näin ollen tutkimuksen tehtävänä on kartoittaa ja arvioida mahdollista potentiaalia kansainväliseen hankintaan erikoistuneelle yritykselle, joka toimii suomalaisten valmistus- ja myyntiyhtiöiden sekä kiinalaisten tavarantuottajien välisillä kasvavilla markkinoilla.

Kansainväliset hankintaan erikoistuneet välikädet ovat yleensä pieniä yrityksiä, jotka ovat vaatineet vuosien verkostoitumistyön. Tämä tutkimus pyrkii määrittelemään kuinka uusi yritys voisi aloittaa toiminnan tällä alalla. Tästä asetelmasta on johdettu tutkimuksen tavoitteet, ja tämän tutkimuksen tulisi vastata seuraaviin tutkimuskysymyksiin: 1) Mitkä vaikuttavat tekijät (driving forces) liittyvät kansainväliseen hankintaan? 2) Minkälainen liiketoimintamalli näistä tekijöistä voidaan johtaa? 3) Mitkä ovat kansainvälisen hankinnan välikäsinä toimivien yritysten tärkeimmät ominaisuudet kansainvälistyville pk-yrityksille?

Tämän tutkielman luo teoreettisen pohjan yllä mainittujen tavoitteiden pohjalta. Tätä varten on tehty laaja katsaus asianmukaiseen kirjallisuuteen ja aiempiin tutkimuksiin yrittäjyyden, hankinnan, kansainvälistymisen, liiketoimintamallien, liiketoimintamahdollisuuksien, sosiaalisen pääoman, verkostoitumisen ja Kiinan yritysmaailman aloilla. Lisäksi tässä työssä on käytetty kyselytutkimusta kartoittamaan suomalaisten pk-yritysten asenteita ja kokemuksia ulkomaalaisten tavarantoimittajien sekä välikäsien suhteen.

Tutkimuksen tulokset osoittavat että hankinnassa on olemassa liiketoimintamahdollisuus, joka juontuu tämän markkinan uusista tarpeista, trendeistä, ja puutteista. Tämä liiketoimintamahdollisuus kumpuaa kansainvälisen hankinnan vaikuttavista tekijöistä, joihin kuuluvat globalisoituminen ja globaali kilpailu, kansainvälistyvien pk-yritysten resurssien puute, sekä kansainvälisen hankinnan yleistymisen. Näin ollen tämä tutkimus on osoittanut, että kansainvälinen hankintayritys ja -yrittäjä voivat tarjota merkittävää lisäarvoa länsimaalaisille pk-yrityksille. Lisäksi tämä tutkimus on osoittanut, että kansainvälisellä hankintayrityksen ja -yrittäjän täytyy omata tietyt pakolliset ominaisuudet ja prosessit, ja nämä ilmenevät tutkimuksessa esitettyssä liiketoimintamallissa.

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# 1. INTRODUCTION

## 1.1 Introduction to the topic

'International sourcing' (IS) refers to the purchasing of materials, components, and finished products from foreign suppliers. IS thrives from globalization, communication technology, and transport system development, as well as the reduction of international trade boundaries. These issues have typically developed rapidly in the Chinese market within the near history, making it one of the most attractive sourcing markets.

To compete in the prevailing global economy western companies are facing the crucial problem of how to source the world's best suppliers and how to capture the best opportunities. However, any internationalizing company has several options based on variations of time and involvement when shifting from domestic sourcing to international sourcing. In the case of small and medium sized companies (SME's) the companies rarely possess the required resources and capabilities for independent foreign trade, and usually they first have to turn to intermediaries to access the foreign supply markets.

*The main purpose of this study is to address the significance of the international sourcing intermediaries in relation to western SME's internationalization process.*

The underpinning purpose of this research paper is to review and assess underlying potential for a Finland-based international sourcing company that operates as an intermediate between the growing market of Chinese quality suppliers and the Finnish sales- and manufacturing companies. This research process is expected to help with a business startup in the supplier sourcing industry. Thus, this study can make a significant difference as it could potentially help a startup company to succeed in the international sourcing business. Furthermore, this research can aid in creating business opportunities for numerous Finnish sales- and manufacturing companies by opening up an access to new Chinese quality suppliers. The research also potentially offers opportunities in the form of business growth and increased employment for a number of Finnish small- and medium sized companies which at the moment do not have resources to do business on their own with the Chinese.

## 1.2 Objectives and limitations

Characteristically, the international sourcing companies are usually small businesses that require years of networking activities and accumulation of knowledge of markets and industries. Also, the industry of IS companies is depicted by fairly uncreative, fragmented, and small players that have a long history of entrepreneurial personal networking behind them. (Nassimbeni & Sartor, 2006) Therefore, this research paper aims to determine a business model for a new IS company start up within this industry.

The objectives of this research project are to determine answers to the following research questions:

*1) What factors have an influence (driving forces) on using international sourcing?*

This research question helps us to find out some insight on whether or not there is an underlying opportunity and call for an IS service within the midst of SME's. Also, because in practice internationalizing SME's can choose among many modes of internationalization this research question allows us to examine what factors contribute towards SME's choosing to use an intermediary in IS.

*2) What kind of business model could be derived from these factors to seize the IS opportunity?*

This research question allows the research to pay attention to the direction of what are the key tasks and main obstacles for an international sourcing company. Also, it forces the research to form a cohesive picture of all aspects of the topic at hand in order to produce a comprehensive business model suitable for an IS company. Presumably, the IS opportunity exists between the emerging market of China and the western SME's as information on firms in the emerging markets is often sparse, difficult to obtain, and highly inaccurate. Obtaining even basic information on suppliers is difficult, not to mention the subjective factors such as their reliability and efficiency. Therefore, this research paper should determine how to benefit from this discrepancy of the western and Chinese markets.

### *3) What are the critical foreign supplier characteristics for internationalizing SME's?*

This research questions forms the basis for this research's empirical study and helps us to trace the prevailing attitudes and experiences of companies that are dealing with international suppliers.

This research's scope has been narrowed down as much as possible in order to grasp the essential information for a business start up in the field of international sourcing. One of the limitations is that the research has been conducted within small and medium sized companies that are only located in Finland. Although the results are comparable to a similar study conducted in Italy (Nassimbeni & Sartor, 2006) it is possible that the results do not apply to all western SME's. A research on a full scale and coverage of the western SME's is beyond the possibilities of this paper.

Also, one of the key tasks of this research is to provide a business model for an IS intermediate. However, the suggested business model is not intended to fully cover all aspects of all the possible business processes because this would require a separate paper of its own. Therefore, the business model presented here is not meant to be a full business plan, and it will rather focus on the driving forces of the IS and the opportunities that exist on the market which shape the critical functions of an IS intermediate. Therefore, many important factors that are normally included in a business plan, for example financial aspects, staffing, competition, as well as marketing functions among many, have been left out of this study.

### **1.3 Structure**

The first part of this paper establishes a theoretical background based for the above mentioned research objectives. Researching previous literature offers a basis for understanding the objectives of the study and helps to create a coherent picture of the topic. For this purpose, a wide variety of literature is covered from the fields of entrepreneurship, supplier sourcing, internationalization, innovation, new business models, identifying business opportunities, building social capital, networking, and business relations. This combination of fields of research is deemed essential by many researchers

(Nassimbeni & Sartor, 2006; Kirby & Kaiser, 2003; Chung 2004) in relation to international sourcing.

The second part of this research consists of primary data findings from a survey study that was carried out among the Finnish small and medium sized companies. This study traces the prevailing attitudes and experiences of Finnish SME's that are dealing with international suppliers. The study is identical to and based on a study that was conducted in Italy in 2005 by Guido Nassimbeni and Marco Sartor.

The final section of the paper proceeds by presenting an analysis of the research, its key findings and their implications. Finally, a *business model* for an international sourcing company is presented.

This study's scope is limited to the following aspects:

- *Internationalizing SME's* – The study focuses on small and medium sized businesses and whether or not they could benefit from international sourcing. The international activities of multinational large corporations (MNC's) do not offer significant information in relation to SME's, who usually have notably limited resources, and therefore the research on MNC's international activities as well as sourcing activities are not included in this study. It is also noted in the study that there is a multitude of internationalization choices and methods for a given internationalizing company, however, this study will limit its scope to research the internationalization process with intermediaries.
- *International Sourcing in China* – The study concentrates on intermediaries' international sourcing activities in the Chinese business environment. There are other globally significant and emerging low-cost sourcing regions, however, each of them are characteristically notably different from each other. Therefore, in order to maintain a manageable scope it is not feasible to include each and every one of them in the same study.
- *New business models as well as opportunity recognition and development* – The study examines the possibility of introducing a new business model within the IS industry in order to service the SME's with limited internationalization resources.



## 2. LITERATURE REVIEW AND THEORETICAL BACKGROUND

### 2.1 Internationalization of SME's

How is 'internationalization' and the concept of an 'international' company defined? Despite the multitude of ways of defining internationalization, researchers do agree that internationalization is a process. Ahokangas (2002) provides a useful definition; *"international business is one that crosses borders of two or more nations, and internationalization is the process of choosing new products, services, markets, organizational structures, personnel, financing, and knowledge that result in an international business."*

Research has shown that small- and medium sized companies (SME's) often lack the resources necessary to internationalize and are therefore reluctant to initiate such an endeavor. The challenges quite often involve limitations such as resource constraints with personnel and production capability, insufficient knowledge about markets and customers, weak financial resources to support growth, and poor skills in internationalization and marketing. Also such factors as financial environment, target market, different cultures and laws, as well as consumer behaviors make it troublesome for a small firm to enter a new market as it calls for a larger effort than starting up operations in a familiar environment. The concept of global small firm is an oxymoron as the main driver of globalization, the scale economies, does not apply to SME's. (Kirby & Kaiser, 2003; Varis, Kuivalainen and Saarenketo, 2005; Zuchella, 2007; Blomstermo & Sharma & al., 2003)

In general, SME's internationalization process theories focus on experience as the main explanation ("learning by doing") where constraints such as lack of knowledge and uncertainty hinder internationalization. (Blomstermo & Sharma & al., 2003; Varis, Kuivalainen & Saarenketo, 2005) Therefore, it seems to be beneficial to utilize knowledge from other firms, organizations and individuals. In essence, networking allows internationalizing firms to complement each others' knowledge and skills, and specialization. Varis, Kuivalainen and Saarenketo (2005) suggest that the key for a

successful international endeavor is to overcome these limitations by using different types of strategies such as networking or other innovative, entrepreneurial strategies. Especially for smaller companies co-operation and partnerships provide a good if not crucial opportunity for reaching the global market. In turn, Zuchella (2007) emphasizes the meaning of entrepreneurial international attitude, orientation, skills, experience, and networks for successful international ventures. Blomstermo & Sharma & al. (2003, 56) emphasize focusing on market knowledge and commitment.

In essence, entrepreneurs can gain access to new markets and to complementary skills and assets by networking and collaborating with their foreign contemporaries. Blomstermo & Sharma & al. (2003) noted that several researches show that market knowledge is gained through networks and interconnected business relationships. It is often the individual personal relationships that dictate the success of an internationalization process. In addition, Varis, Kuivalainen and Saarenketo (2005) state that often the innovative and entrepreneurial activities in an internationalizing company can actually be traced to individual managers within the company. Also, Zuchella (2007) asserts that SME's international success is often deeply connected to entrepreneurial owners' pre-existing experiences, skills, and networks.

In practice there are numerous modes of internationalization that any firm may choose from when looking into starting up an internationalization process, such as joint ventures, establishing international offices, selling license to foreign companies, or using intermediaries, etc. Companies' motives, barriers, resources, target market and competition among others have an effect on the proper mode of internationalization. Naturally, the internationalization process for SME's has to be examined from a different perspective than that of the multi-national corporations (MNC's).

Kirby & Kaiser (2003) conducted a study on UK and Germany based SME's that started international operations with Chinese joint ventures and found out that experiences of the firms were similar to those of the MNC's. These authors' research indicated that for example joint ventures with foreign companies solved some of the problems of internationalization. Foreign partner's attributes appreciated by western companies were local business knowledge, ownership participation, smoothing way through bureaucracy, knowledge of customers, and lower requirement for financial inputs. Due to obvious

limitations the SME's operating in the global markets usually need mutual collaboration to avoid the obstacles of small scale and clearly they need assistance at least in partner location and selection processes. Because of the ability to use international partners, the limited resources of SME's do not necessarily prevent building up an active international presence.

### **2.1.1 Supplier partnership selection**

Partnering strategies can vary from value-chain partnerships with suppliers and buyers to licensing agreements to R&D partnerships and to equity joint ventures. However, this study will focus on *supplier partnerships* which are defined as ever ongoing long-time relationships with a supplier of a critical good or service.

In past research, the focal point seems to have been on the benefits and risks of SME partnerships while very little research has looked into the dynamics of cooperation and management of partnerships. All in all, the research on partner selection of SME's is still quite underdeveloped and constantly evolving. (Kirby and Kaiser, 2003; Beekman and Robinson, 2004; Varis, Kuivalainen and Saarenketo, 2005)

Effective partner selection is regarded as one of the most crucial tasks in internationalization. Manufacturing and sales companies have to be looking into sourcing the best suppliers and capturing the best opportunities in order to compete in the global economy. The selection of a good and reliable trading partner in a foreign market is one of the most difficult and challenging tasks. Furthermore, the choice of partners is bound to have a profound impact on the success on international endeavors. (Nijssen, Douglas & Calis, 1997; Kirby and Kaiser, 2003; Beekman and Robinson, 2004; Varis, Kuivalainen and Saarenketo, 2005) Nijssen, Douglas & Calis (1997) make an additional note that this is especially true in emerging markets as information on firms is typically sparse, difficult to obtain, and often highly inaccurate. Obtaining even basic information on suppliers is difficult, and yet quite apart from subjective factors such as their reliability and efficiency.

According to the often cited resource-based view, firms look for partners who have resources that they lack themselves. The usage of external resources, acquired through

long-term relationships, can generate growth and can help in the pursuit of opportunities. (Kirby and Kaiser, 2003; Beekman and Robinson, 2004; Varis, Kuivalainen and Saarenketo, 2005)

Beekman and Robinson (2004) noticed that new ventures often seek for partners because they have no track record of success. Thus, 'the liability of newness' is reduced through partnering. However, the authors also notice that because growth is often the thrusting factor in many firms they tend to take advantage of new opportunities by instituting relationships with new suppliers. This search for new opportunities and growth can have an adverse effect on existing supplier relationships. More often, however, growth will deepen the relationship further as for example increased sales will benefit both parties of the partnership and normally new product lines will not disclose the usability of an existing partner. This may be one of the reasons why there is often a '*reluctance to change*' a partnership. In practice, firms tend to continue and manage a relationship with a given partner on a routine basis after the initial selection process and they are not easily willing to change this process. (Beekman and Robinson, 2004, 3 – 5)

Beekman and Robinson (2004) and Varis, Kuivalainen and Saarenketo (2005) say that building an international value-network for a firm calls for constant proactive evaluation with company-specific criteria of both the existing network as well as potential partners. The selection process needs to be well defined and understood, and that in partnerships commitment and compatibility is crucial because of the long-term implications. A functional example of this process with good historical experiences of performance is chronological and has four evaluation stages: 1) *Business criteria* involve the partner's historical and financial performance and industry focus. 2) *Marketing criteria* involve marketing capabilities and resources, existing company connections with customers and competitors. 3) The *partner-potential criteria* comprise of future potential, business culture, relationships, personnel and reputation. 4) *Technical criteria* refer to any number of relevant technical details and compatibilities. (Varis, Kuivalainen and Saarenketo, 2005, 27)

However, Nijssen, Douglas & Calis (1997) suggested that the depth of systematic formal procedures in the partner search process does not offer a positive effect on finding satisfactory business relationships, but on the contrary informal and personal contacts

posed a significant positive effect on the quality business relationships. According to these authors' study, the key factor in satisfactory partner selection seemed to be the management's proactiveness in the search process. The top of the list of information sources for potential partners includes; 1) other companies in emerging market (e.g. transportation firms, insurance companies) with 65% in survey popularity, 2) Informal sources in emerging market (e.g. acquaintances) with 54% popularity, 3) International import/export guides with 54%, 4) the potential partner itself with 43%, 5) other companies in home market (e.g. competitors, suppliers) with 43%, and finally 6) trade fairs and conferences with 43% popularity.

## 2.2 International Sourcing (IS)

### 2.2.1 Introduction to IS

Traditional approach emphasizes the outsourcing of activities and processes through strategic contracts to acquire operational efficiency and enhancing value-adding business capability by allowing the company to more effectively utilize its inputs. (Porter, 1996; Chung, 2004) The manufacturing environment's competition is today marked by shorter product life cycles and increasing demand for product customization. Manufacturers are under pressure from customers to move away from the traditional "make-to-stock" production model to "build-to-demand" customer service model. This leverages product information throughout the supply chain and promotes clearer visibility in the supply chain to ensure customization and rapid delivery of innovative products. (Chung, 2004)

'International sourcing' (IS), according to Nassimbeni and Sartor (2006 & 2007), refers to the "...*purchasing materials, components, and finished products from foreign suppliers.*" IS thrives from market globalization, communication technology, and transport system development, as well as the reduction of international trade boundaries. These are all issues which have typically developed enormously in the Chinese market within the near history, making it one of the most attractive sourcing markets thanks to the low cost of manpower, the rapid increase in the quality and quantity of its products, the availability of major logistic platforms, and the possibility of establishing a presence in possibly the world's largest market. Similarly, Cheng (2004) points out that the advantages of Chinese low cost sourcing can offer western companies most notably *lower labor costs*, but also *long-term flexibility in production, lower capital costs, and favorable tax structures* for companies making foreign direct investments.

However, along with the emergence of IS in China some recurring problems have arisen, such as; cultural and communication barriers, longer supplying lead times, higher transport costs, quality issues, risks linked to business transactions with different contact people and different regulations. (Nassimbeni and Sartor, 2006; Kirby & Kaiser, 2003) Two most troublesome aspects for western companies seem to be the logistics problems in China, and culture differences in business conduct. (Nassimbeni and Sartor, 2007) In addition,

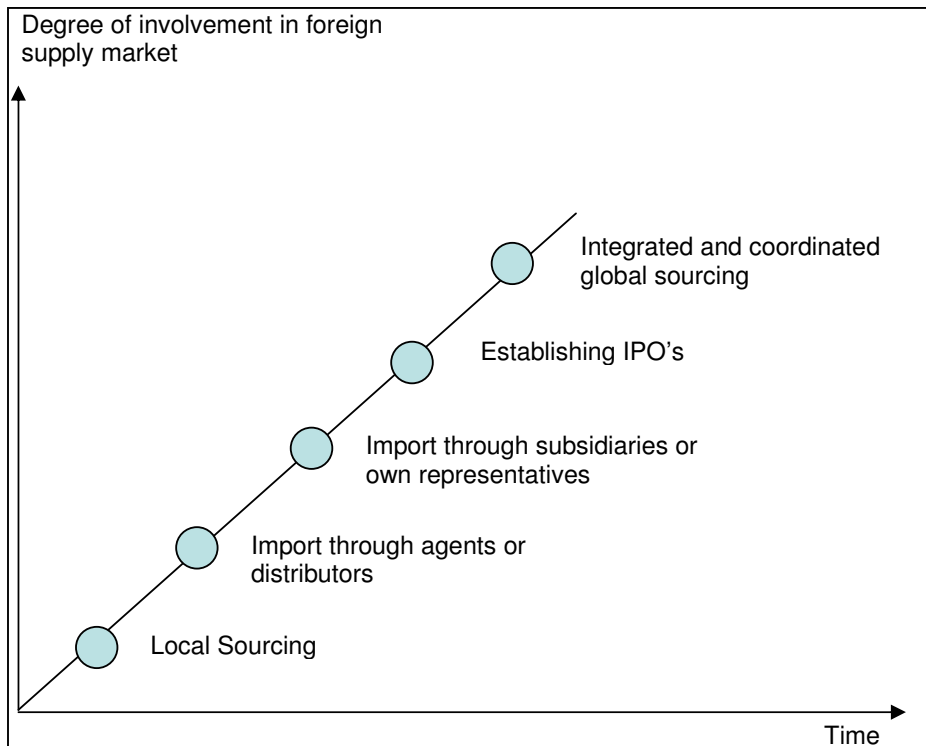
Cheng (2004) notes that companies considering business relationship with China needs to account for longer start-up time of operations, weak intellectual property protection, increased management complexity, as well as energy shortages and other operational hiccups.

However, the real problems with IS in China arise each time the buyer has to decide where to buy or how to find the best suppliers and opportunities, as well as each time when the buyer has to analyze the risk of the operation: It crucial to be able to identify the right partners for the network. When sourcing from China one needs to think about total landed cost, and whether in the end the product matches the needs. It must not be self-explanatory just to have something manufactured at low cost. Production has to meet all the company's specific requirements and the country's regulatory requirements among other things. (Nassimbeni and Sartor, 2006; Niemelä, 2002, 103; Chung, 2004)

To compete in the prevailing global economy, Nassimbeni & Sartor (2006), Niemelä (2002), Kirby & Kaiser (2003), Chung (2004) and Beekman & Robinson (2004) point out that western companies are facing the crucial problem of how to source the world's best suppliers and how to capture the best opportunities: In today's global environment the effect of materials on the cost of a product is much higher than labor which makes low-cost-country sourcing very attractive, especially for "labor intensive" products. This means local companies have to shift from simple dealing with local operators into dealing with different cultures, laws, practices, and people. In the modern global economy offshore sourcing is no longer only the strategy for a few advanced organizations but it is the common contribution to any company's competitiveness and survival. However, Cheng (2004) says that the Chinese low-cost sourcing is not the solution for all companies. According to him, the choice is heavily dependant on the product needed. Traditionally China is notably excelling in components and goods made on templates, such as furniture, toys, and consumer electronics and appliances. Also, more recently telecom, biotechnology, and electronics have been emerging as new Chinese strengths.

Nassimbeni and Sartor (2006, 4) introduce the 'Rugman model' (Figure 1) to explain different approaches on IS for different types of companies interested in low-cost sourcing. According to this model, any internationalizing company has several options based on variations of time and involvement when shifting from domestic sourcing to international

sourcing. When the company does not yet possess the required resources and capabilities for independent foreign trade they usually first turn to intermediaries to access the foreign supply markets. The following step is to establish foreign subsidiaries. When the involvement and investment level increases the companies often establish foreign purchasing offices (IPO) to manage foreign purchasing on site. And finally global sourcing refers to companies that have located production and supply networks abroad.



**Figure 1: The Rugman Model**

Different sourcing approaches presented by the Rugman model, which defines different sourcing approaches according to two variables; time and involvement level in the foreign markets. (Nassimbeni and Sartor, 2006)



### 2.2.2 IS determining factors

There are a multitude of reasons why it can be feasible for companies to look into international sourcing as a business strategy. Kirby & Kaiser (2003) noted that the primary motivations for SME's that are interested in a project in China are the size of the market, the availability of cheap labor, and knowledge of Chinese business world. In addition, Kirby & Kaiser (2003) found out in their research that the most important requirements for successful business relationship between western and Chinese company were sincerity, patience, good business connections, and good products.

Nassimbeni and Sartor (2006) say that the determining factors include the following:

- *Reduction of purchasing costs* remains the key element of motivation, in which the global purchasing coordination is one of the main reasons for achieving economies of scale. According to surveys it has been estimated that the use of international supply markets result in the corresponding cost advantages of 15 to 25 percent.
- *Access to distinctive resources or capabilities* often represents the second most important factor in IS strategy, particularly in the form of search for the best price/quality ratio. In the past international sourcing has been linked with high risk in terms of product quality, however especially in the case of China the findings of recent studies have been considered 'unbelievable'. The quality risk reduction is mainly linked to the development of transport networks, advances in manufacturing technology, and the spread of modern information and communication technologies which enables faster coping with unexpected situations.
- *Possibility of increasing the number of suppliers available*, which naturally offers companies a greater variety and flexibility of production.
- *Possibility of establishing a presence in a foreign market* can sometimes be advantageous, or even necessary for a company to establish sales.
- *Trade barrier reduction or other international agreements*, such as the creation of geographical trade areas like NAFTA or the EU may or changes in trade organizations like the China's entering to WTO may all inspire companies to enter a foreign trade relationship.

(Nassimbeni and Sartor, 2006)

### 2.2.3 IS inhibiting factors

There are also several issues that hinder the usage of international sourcing. Based on Kirby's & Kaiser's (2003) research, the most severe problems are related to quality issues and personnel capabilities, training, and productivity. According to Nassimbeni and Sartor (2006) they involve the following:

- *IS costs* may involve additional cost on top of the actual product purchasing costs. Often companies have insufficient resources for these costs that may involve such as storage costs, supplier selection and auditing costs, conformity with regulations, material flow monitoring costs, etc. If a company does not have suitable resources to tackle these issues directly they may be able to refer to various intermediaries.
- *IS lead times* can vary according to geographical distance, material type, transport methods, packaging incompatibility, and infrastructures of the countries of transport. Therefore companies have to take into account the risk of delays.
- *Cultural and linguistic differences* play an important role when a company decides to engage IS and may result in a variety of problematic situations.
- *Knowledge/technology expropriation risk* rises out of the geographical distance which restricts the possibility to control the business counterpart. Especially when dealing with countries like China, foreign companies have to acknowledge the risk of 'copies'. However, this risk is decreasing by the time, particularly because of China's recent union with WTO. Also, today the western companies are all the more experienced in protecting themselves against these types of violations.
- *Instability of foreign markets* may involve especially various political and economical issues.

Nijssen, Douglas, and Calis (1997) conducted another study on the problems associated with evaluating and selecting a foreign supplier partner. They found out that the problems are closely related to lack of reliable information and the need to assess the partner's reliability. Estimating the credibility of a supplier is reported as the main problem (31 percent). Language barriers and cultural differences (25 percent) also posed difficulties as they tend lead to communication and misinterpretation problems. The time and costs associated with evaluating partners (19 percent), difficulties in identifying the right person to negotiate with in the emerging market company (13 percent) and the rapidly changing legal environment of the target market were also considered to be significant problems.

#### 2.2.4 IS with intermediaries

There is a key motive for any international sourcing companies' consideration; the basic decision involved in choosing the intermediaries. A decision must be done on whether the company should use *indirect* or *direct* IS approach. *Indirect* IS-operations involve dealing with intermediaries. The benefits, especially in short term, are that the company uses someone else's resources for operations. However, this strategy includes concern for the long run benefits, especially for a company that is aspiring to grow internationally on their own. With *direct* IS strategy, the company takes an active responsibility for its operations abroad by investing time and resources. (Czinkota, Ronkainen and Ortiz-Buonafina, 2004; Nassimbeni and Sartor, 2006)

According to Nassimbeni and Sartor (2006) companies that lack the resources and capabilities for independent IS tend to enter and explore international supply markets through specialized intermediaries, agents and distributors. This sourcing type transfers the responsibility for negotiation and management of the supply relationship to the intermediaries. Therefore it is less risky and simpler to a company that is starting up an IS process. However, the authors point out that in this case the purchasing costs will also be higher because of the intermediation costs included. Also, although lack of control may have both pros and cons in IS, but solutions provided by third party may not be the best for the company that refers to an intermediary. (Nassimbeni and Sartor, 2006, 22)

Nassimbeni and Sartor (2007, 8) identify two methods for 'intermediated sourcing'; traditional intermediation and international outsourcing of services. In the case of the former, intermediaries act as international wholesaler who buys products on the Chinese market and sells them on some other market. In the case of *international outsourcing of services* the intermediary provides a set of services; analysis of the Chinese offer, identification of potential suppliers, agreement definition, quality checks, screening of international carriers, monitoring of the suppliers, etc. Especially in the case of SME's, who rarely have suitable resources and expertise to independently manage a sourcing channel in China, the intermediary acts as an International Purchasing Office for these companies. Therefore, intermediation can be a relatively effective and safe way to test the Chinese market before beginning to source directly.

According to Nassimbeni's and Sartor's (2007) study, intermediation was effective mainly for two activities; the negotiations, and the monitoring of the execution of the technical specifications. In negotiations the Chinese suppliers are often tempted to continuously reduce prices by changing some specifications in order to meet the agreed target price. Because of this, a need arises for an intermediate to be able to establish suitable relations with the manufacturer and, at the same time, to offer adequate warranties to the Western customer.

### **2.2.5 IS in China**

China's opening to foreign trade has encouraged both the researchers as well as the managers to analyze the characteristics, opportunities, potentials, and problems of this market. According to the literature research of Nassimbeni and Sartor (2006) there is a shortage of studies on other sourcing modes than foreign direct investment. The authors note that this is especially unfortunate for small enterprises that do not possess adequate financial and managerial resources to establish equity participation in the Chinese market. Also, organizational and managerial requirements for small business sourcing activities such as supplier selection, product selection, and establishment of international purchasing offices, are rarely considered. (Nassimbeni and Sartor, 2006, 32)

Williamson and Ming (2008) note that despite the prevailing negative connotations related to the Chinese manufacturers there is no more room for attitudes that take Chinese production as the cheap, low-quality imitations that flood the world markets. On the contrary, the Chinese are excelling in terms of '*cost innovation*', the strategy of using Chinese cost advantage in radically new ways to offer more for less to the end users around the world. 'Cost innovation' pertains that Chinese manufacturers are now offering 1) high technology at low cost, 2) unmatched range of products for customers' choosing in markets that used to be considered standardized, and 3) specialty products by turning them into volume businesses with their low cost advantage.

Often managers in high-cost countries have responded to the Chinese competition by shifting their focus to the high-end segment of the market. However, this strategy is difficult to maintain as volumes and the market tend to get smaller which means it becomes increasingly hard to invest in R&D activities to maintain the high-end advantage with the Chinese competition. Chances are that manufacturing costs are driven up while volume falls and production becomes subscale. Williamson and Ming (2008) suggest that radical changes in the western companies' strategies are called for in order to respond to the emerging Chinese competition. These authors say the western companies have three choices; using 'cost innovation' themselves, giving a global mandate to your China subsidiary, or allying with the Chinese through partnership or acquisition: *"One way or another, you need to access Chinese cost innovation capabilities, whether by direct observation, by developing and restructuring your own operations in China to capture more learning, or through acquisitions or alliances."* Despite the involvement method selected, the prerequisite for all above mentioned initiatives is the difficult adjustment of your mindset; to accept China as the source of complex learning that can help deliver high technology, variety, and specialist offerings at low cost to improve global competitiveness.

## 2.3 Social Capital

Social capital is defined by Nahapiet & Ghoshal (1998) as the combination of exchange of intellectual capital in network of relationships of an entrepreneur. Dakhli & De Clercq (2004) define social capital as the “...*networks of relationships (that) constitute, or lead to, resources that can be used for the good of the individual or the collective.*”, and as a phenomenon that has implications “...*at multiple levels, including the individual, organizational, and societal.*” Tura & Harmaakorpi (2005) define social capital as the social, structural, and cultural *environment*, with possessions of relationships in collectives, *where innovations emerge.*

In general, researchers seem to agree that social capital plays a critical role relation to why some entrepreneurs succeed better than others. The key elements of social capital are high levels of trust, strong network of contacts on a personal level, thriving societies, common grounds for comprehension, and feeling of cohesive and equal participation. Social capital can exist within or between nations, regions, organizations, and individuals. Many issues in relation to social capital and especially trust can only be resolved with the gradual accumulation of experience. (Nahapiet & Ghoshal, 1998; Dakhli & De Clercq, 2004; Tura & Harmaakorpi, 2005; Smith & Lohrke 2008; Ostgaard & Birley, 1996; De Carolis, Litzky and Eddleston, 2009; Ostgaard & Birley, 1996)

Nahapiet & Ghoshal (1998) offer a widely accepted analytical separation of social capital's dimensions: 1) *The structural dimension* comprehends the structure of the network as a whole; the linkages between actors that provide the means to access to knowledge and resources. 2) *The relational dimension* includes the forms of personal relationships between the members of the network that form assets to the network, such as trust, reputation, friendship, and respect. 3) *The cognitive dimension* involves the social system's shared social assets and resources, such as shared representations, interpretations, values, and meanings (i.e. language and codes of meaning) which act as the facilitators of interaction between the individuals within the structure. (Nahapiet & Ghoshal; 1998) This definition is used in this paper to further examine the dimensions of social capital.

### 2.3.1 The structural dimension

*The structural dimension* comprehends the structure of the network as a whole; the linkages between actors that provide the means to access to knowledge and resources. (Nahapiet & Ghoshal; 1998)

Networks are groups of people, firms, or organizations that collaborate and interact together within the network structure. Niemelä (2002) and Smith & Lohrke (2008) stated that there are several characteristics that make networks profitable: Essentially networks benefit the members at least in increasing specialization of skills and resources, as well as more efficient marketing, production, logistics and financing activities. Networks are by nature dynamic and adaptive to their environment. De Carolis, Litzky and Eddleston (2009) say that networks connect the entrepreneur with opportunities critical to a firm's success, facilitate innovation, spread risks, and provide support, credibility, and contacts for entrepreneurs.

Several authors (Ostgaard & Birley, 1996; Smith & Lohrke, 2008; Nahapiet & Ghoshal, 1998; De Carolis, Litzky and Eddleston, 2009) suggest that because of small firms' resource constraints, entrepreneurs often form social network ties by '*networking*' with outside entities in an effort to provide critical resources. *"Such ties form the entrepreneur's "social capital", or the sum of the actual and potential resources embedded within, available through, and derived from a relationship network."* (Smith & Lohrke, 2008) On the other hand, Ostgaard & Birley (1996) say that firstly the entrepreneurial process involves gathering of scarce resources from the environment and secondly, resources are normally obtained through the personal network of the entrepreneur.

Smith & Lohrke (2008) say that new ventures that are lacking strong network relationships generally face high mortality risks, a condition that entrepreneurship research has long referred to as the 'liability of newness'. Ostgaard & Birley (1996) also say that in the absence of a proven track record for a new firm the entrepreneur has to rely on personal credibility and personal networks. Similarly, the study of Fisher & Reuber (2003) showed that especially immature growth firm owners need to engage in networking activities in order to develop necessary ties beyond their personal contacts and their local

communities. An entrepreneur who can successfully overcome this liability by convincing resource providers that a new venture is both viable and legitimate will have a better chance of acquiring resources, and in increasing the venture's success chances. (Smith & Lohrke, 2008; Fisher & Reuber, 2003; Ostgaard & Birley, 1996)

McDougal et al (1994) researched International New Ventures (INV) that by definition are *"business organizations that, from inception, seek to derive significant competitive advantage from the use of resources and the sale of outputs in multiple countries."* Founders of INV's are individuals who are open to and aware of international opportunities as well as constantly alert to the possibilities of combining resources from different international markets because of their specific competencies. In essence, these entrepreneurs believe that *"the advantage of starting internationally is that you establish an international spirit from the very beginning"*. Based on the findings of their INV research McDougal et al (1995) stated that founders of INV's prefer to use strategic alliances and networks for their international startups as a way to overcome the usual lack of resources. The authors say that INV's can succeed only if the entrepreneurs have a global vision, international business competence, and an established international network, and that from the start INV's should create hybrid structures to preserve scarce resources. Essentially, successful INV entrepreneurs are adept with international strategy because they focus on identifying scattered opportunities that others do not see, because they engage international activities from the start to avoid getting path-stuck on domestic environment, and because they are able to preserve resources by utilizing hybrid governance structures. (McDougal et al, 1994, 15)

Smith & Lohrke (2008), Nahapiet & Ghoshal (1998), and Ostgaard & Birley (1996) suggest that venture's success may be predicated from an entrepreneur's ability to accumulate social capital and to assemble critical resources via a network of exchange relationships. This view includes many aspects such as social interactions and the degree of trust in the relationships. In general, within the contexts of building efficient networks trust seems to play a key role in this entrepreneurial process of networking.

New firms typically lack company identity, brand name, and legitimacy, which makes it difficult for them to enter exchange relationships as their credibility, promises, and staying power are easily questioned. Gruber (2004) states that it is very feasible for a new venture



entrepreneur to sell to customers who are personally know to them. Therein the anonymity and lack of credibility of the firm is less important as they are compensated for by a strong person-based credibility. This strategy allows the firm to make its first sales quickly, to prove the functionality of its product, and thereby generate firm-based credibility. This may easily lead the firm to achieve a position in the marketplace through the usage of 'word-of-mouth' and 'buzz' marketing, as well as other 'guerilla' marketing techniques. Also, emerging firms are often able to cite their relations to early buyers, to certification agencies and to strategic alliances with top-tier established firms to draw credibility value from the trust that these associates enjoy, because their reputation can be transferred to the emerging entity, creating a 'halo effect' of trust. (Gruber, 2004, 180 – 190)

Another significant aspect for a network to consider, according to Niemelä (2002), is the customers, i.e. maintaining, supporting and renewing the network's contacts to customers. This author suggests that in practice a network could use a certain key player that operates as the *engine of the network*. This key member is a driving force for the network which specializes in customer relations and network coordination. This engine for the network is the player that coordinates operations such as logistics, marketing, branding, and product research and development among others based on customers' demands and mindsets. The engine member in a way acts as the network's central node between the production network and the sales network.

### 2.3.2 Relational dimension

*The relational dimension* includes the forms of personal relationships between the members of the network that form assets to the network, such as trust, reputation, friendship, and respect. (Nahapiet & Ghoshal; 1998)

Parkhe (1998) as well as Baron and Markman (2003) noted that in global competition one cannot survive without international collaboration and alliances, and that the single most important aspect of international collaboration is trust. According to Parkhe's study, managers can intentionally lead the process of developing trust, although it usually involves deliberate investments of time, funds, infrastructure and people. Managers should also be aware of the five dynamics of trust that are essential; 1) understanding the past and how trust has developed in a particular alliance, 2) understanding that trust has to be build slowly, and that haste is costly and destabilizing, 3) address partners' strategic directions, which can be different from your own if levels of trust are sufficient, 4) address value creation asymmetries to avoid inequality, and 5) pay close attention to staffing issues by locating the appropriate people to appropriate situations in the alliance interface, and limiting their turnover.

In Parkhe's (1998), Niemelä's (2002, 78-79) and Dakhli's & De Clercq's (2004) point of views, trust can be categorized to three to four different levels: On the first level there is very little trust; contracts are not respected, promises are broken, and one's weakness is used for others' advantage. In general, corruption describes this activity. This level is disregarded by Dakhli & De Clercq (2004) as in essence no trust exists in interactions. On the second level trust is based on control measures such as detailed contracts and the threat of legal measures in the case of non-compliance, however, the members of a network are willing to build their relationship as they know that collaboration is the only way to build a better tomorrow. On the third level, trust is still based on contracts, but honor and integrity are essential parts of negotiations. Negotiations can be carried out effortlessly and without lengthy legal documents and third party interventions. In case of problems, they are worked out together by finding a mutually beneficial solution. On the highest level, trust is based on mutual compliance and devotion, even feelings, which is manifested as interdependent collaboration that can very effectively thrive for cohesive

long term benefits. This type of reliability can only be achieved through long and successful relationship building.

In addition, Dakhli & De Clercq (2004) noted that different countries may have typically significantly different views of trust; e.g. Japan has a positive view and high levels of trust, whereas USA has a pessimistic view of trust and high levels of monitoring. Niemelä (2002), and Dakhli & De Clercq (2004) note that in Finland we are in a good position to build social capital because of the degree of cultural stability and integrity that prevails in our environment, however, should we choose to expand internationally this 'solid' cultural background can turn out to be just as hindering or beneficial.

Dakhli & De Clercq (2004) also noticed that many researchers have argued that trust fosters innovation similarly and in relation to social capital: Whereas tight monitoring and controlling diminishes creativity, freedom from rigid rules and job definitions enhances idea generation. In addition, trust plays a key role in interactions of organizations: Literature on innovation shows that development and adoption of new knowledge, processes and products, as well as the capacity to maintain a continuous flow of innovations, is dependent on trust, and facilitated by trust between organizations that collaborate. Trust facilitates social exchange, and reduces the need for monitoring. Therefore time and resources can be assigned to more beneficial operations and endeavors that ultimately lead to R&D related actions and inventions. Nahapiet & Ghoshal (1998) state the same; in networks social capital minimizes redundancy, increases efficiency especially by creating effective ways of distributing information, and minimizes transaction cost because of lessening need for monitoring. This ultimately leads to alternative opportunities for resources saved from adaptive efficiency.

### 2.3.3 Cognitive dimension

*The cognitive dimension* involves the social system's shared social assets and resources, such as shared representations, interpretations, values, and meanings (i.e. language and codes of meaning) which act as the facilitators of interaction between the individuals within the structure. (Nahapiet & Ghoshal; 1998)

Several researchers (Nahapiet & Ghoshal, 1998; Tura & Harmaakorpi, 2005; and Baron & Markman, 2003; Carolis, Litzky and Eddleston, 2009) state that social capital plays a crucial role in entrepreneurial success. High social capital allows entrepreneurs to access crucial resources, such as information, increased cooperation with others, and trust. Also, entrepreneurs who possess high levels of social capital are more likely to be able to find financial resources. Baron and Markman (2003) suggest that entrepreneurs' social competence plays an important role in building social capital; *"the higher entrepreneurs' social competence, the greater their financial success."* According to these authors' study, people who have good skills in social perception, communication, impression management, social adaptability, and ability to express feelings and emotions in a proper manner are much more likely to succeed financially as entrepreneurs. The use of language together with cultural differences play key role in building social capital.

Similarly Litzky and Eddleston (2009) and Ostgaard & Birley (1996) suggested that a type of *'cognitive biases'* make some entrepreneurs more successful than others and thus aids some new ventures. In essence, cognitive biases represent the way in which entrepreneurs think, reason, and reach decisions. Therefore social capital is affected by individual perceptions of situations, i.e. each of us experiences and interprets the same situation differently. Again, language and cultural differences affect greatly how we individually interpret a given situation and thus also have an effect on building social capital.

## 2.4 Identifying and Developing Business Opportunities

The German Historical School's supporters' notion of economic innovation is defined in the work of Schumpeter (1934), with the concept of "*creative destruction*" that explains the process of change and radical innovation. According to Drucker (1985), researchers regard Schumpeter's theory of innovation widely influential even today. With the introduction of an innovation that disturbs the economic market situation "*creative destruction*" creates economic discontinuities and an entrepreneurial environment for earning monopoly profits. In Schumpeter's view, entrepreneurs' innovative actions are the sustaining force of economic growth. Schumpeter identified in his research five key elements of innovation that can promote creative destruction and temporary monopolies: 1) Introduction of new product or a new quality of an old product. 2) Introduction of new method of production. 3) Opening of a new market. 4) Introduction of a new source of supply. 5) Introduction of a new organization.

Similarly, in a study of modern innovations, Janszen (2000) defines that innovation is either 1) *introducing new technologies*, 2) *introducing new applications in the form of new products and services*, 3) *development of new markets*, or 4) *the introduction of new organizational forms*, or a combination of these activities. According to this author, innovations lead to increased customer value, to increased shareholder value, and to extra sources of cash flow consequently.

In research it is often emphasized (Schumpeter, 1934; Drucker, 1985; Shane & Venkataraman, 2000; Baron & Markman, 2003) that innovativeness is a critical source for value creation, and that innovations have a great influence on companies' entrepreneurial and organizational behavior, growth possibilities, opportunities, business structures, strategies, processes, and products. Drucker (1985) stated that innovation is an economic or social term rather than technical term. Therefore, as shown by later research (Baron and Markman, 2003.), highly innovative firms have proved to be more successful. Also, innovations do not occur by themselves but rather they are the results of intentional entrepreneurial processes related to opportunity development. Systematic innovation process consists of the purposeful and organized search for changes, and their systematic analysis may offer for social or economic innovation.

Drucker (1985) condensed in his work that *“opportunity is the source of innovation”*. Shane and Venkataraman (2000) define that entrepreneurial opportunities *“are those situations in which new goods, services, raw materials, and organizing methods can be introduced and sold at greater than their costs of production”*. Ardichvili, Cardozo & Ray (2003) established that *“...opportunities are made, not found... by careful investigation of and sensitivity to market needs and as well as with an ability to spot suboptimal deployment of resources”*. Schindehutte, Morris & Pitt (2009) define that business opportunities are *“situations in which goods, services, raw materials, markets, and organizing methods can be introduced and sold through the formation of new means or ends.”*

Ardichvili, Cardozo & Ray (2003) say that in the simplest form opportunity is imprecisely defined market need, under-employed resource, or combination of these two which leads to value creation. Furthermore, Shane & Venkataraman (2000) as well as Schindehutte, Morris & Pitt (2009) separate the notion *entrepreneurial opportunity* from other opportunities. Schindehutte, Morris & Pitt (2009) say that in order to exploit an entrepreneurial opportunity one must find means to an end with resources not yet under the control of entrepreneur: *“Entrepreneurial opportunities are opportunities to act in the creation of value.”* Business opportunities normally emerge from the business environment and more specifically from the existing gaps, new trends, sudden changes, or new necessities in the markets.

Schindehutte, Morris & Pitt (2009) point out that although ideas and opportunities are sometimes hard to distinguish they should not be mixed as this leads to business failures. Not all ideas lead to business opportunities, and to be considered as a possible opportunity an idea 1) must be determined by a window of opportunity (timely), 2) must have profit-making potential (attractive), 3) must be sustainable over a period of time (durable), 4) and must be incorporated with a product, service, or process that creates value for the buyer and/or user.

Ardichvili, Cardozo & Ray (2003) identify five major factors that influence the core process of opportunity recognition: 1) Entrepreneurial alertness, 2) information asymmetry and prior knowledge, 3) social networks, 4) personality traits such as optimism, efficiency, and creativity, and 5) the type of opportunity itself. Baron (2006) sees opportunity recognition

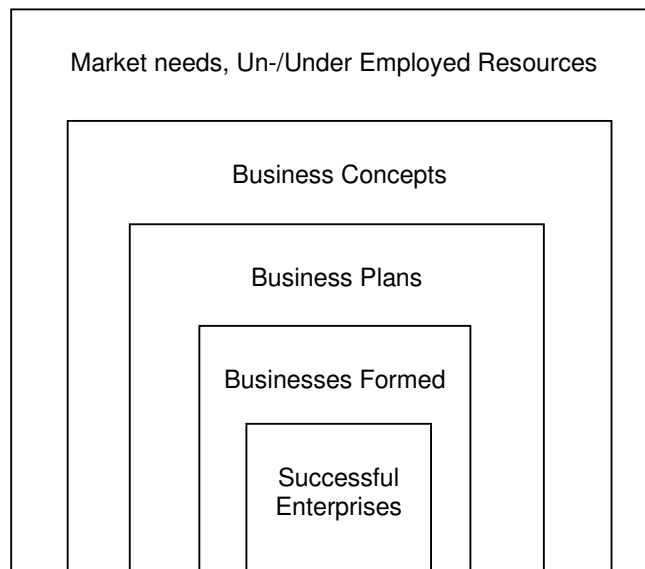
as a combination of active search for opportunities, alertness, and prior knowledge of market.

Similarly Schindehutte, Morris & Pitt (2009), and Baron (2006) assert that opportunity identification and development requires knowledge and experience of the market, especially because current and potential customer behavior knowledge is crucial for successful value creation. Therefore, the entrepreneur's personal experiences as well as market forecasts based on market research combined together form a combination that facilitates opportunity identification. Also, conscious acts of recognizing and pursuing opportunities consistently makes people and firms more opportunity aware and thus speeds the process of opportunities identification. Due to above mentioned reasons, these authors stress the importance of being alert to surrounding information at one's disposal as well as surrounding problems that can be solved.

Shane & Venkataraman (2000) that in order to discover opportunities entrepreneurs must have (1) the possession of the prior information necessary to identify an opportunity and (2) the cognitive properties necessary to value it. Baron (2006) also suggests that it is possible for an entrepreneur to develop sensitivity for certain types of patterns in a given industry or market. Research has proven that entrepreneurs who observe various events or changes are some times able to recognize links or connections between them and therefore able to pinpoint an underlying opportunity. However, most often when opportunities are recognized, entrepreneurs make the identification based on only a few familiar characteristics that they notice.

According to Schindehutte, Morris & Pitt (2009), opportunities can be divided into three different categories: *Opportunity Creation* applies to situations where neither supply nor demand exists and effectuation takes place through experiments that lead to creation of opportunities (e.g. Post-it notes, Teflon, or Velcro). With *Opportunity Discovery* supply or demand does not exist and thus the non-existent side has to be discovered. Efforts are driven by the environment to find a solution to existing problem (e.g. laser eye surgery when laser technology emerged, or medicine for AIDS when the disease became widespread.) With *Opportunity Recognition* both supply and demand exist and thus there is an opportunity to bring together the supply and demand for example by market trends' pattern detection (e.g. Dell computers, Starbucks, or Amazon.com.).

Ardichvili, Cardozo & Ray (2003) say that the creation of successful business is the result of a successful opportunity development process which includes recognition of the opportunity, its evaluation, and development. The process is cyclical and ever continuing as the entrepreneur reviews the opportunity, its development and performance in several stages of the development. Opportunity development progresses from opportunity identification to a defined business concept which defines potential uses for the opportunity, and further on it grows into a business model that includes a detailed business concept and financial model for all stake holders. At the finest and most detailed level the result of this development process is the business plan. In essence, *“opportunities begin as simple concepts that become more elaborate as entrepreneurs develop them.”* Ardichvili, Cardozo & Ray (2003) use a “stage-gate” procedure (Figure 2) for scrutinizing whether or not an opportunity can create value. Typically, opportunities go through several stages of evaluation and planning and whether or not they pass on to the next level depends on a number of constraints of prevailing circumstances.



**Figure 2:** Stage-gate model  
Ardichvili, Cardozo & Ray (2003)

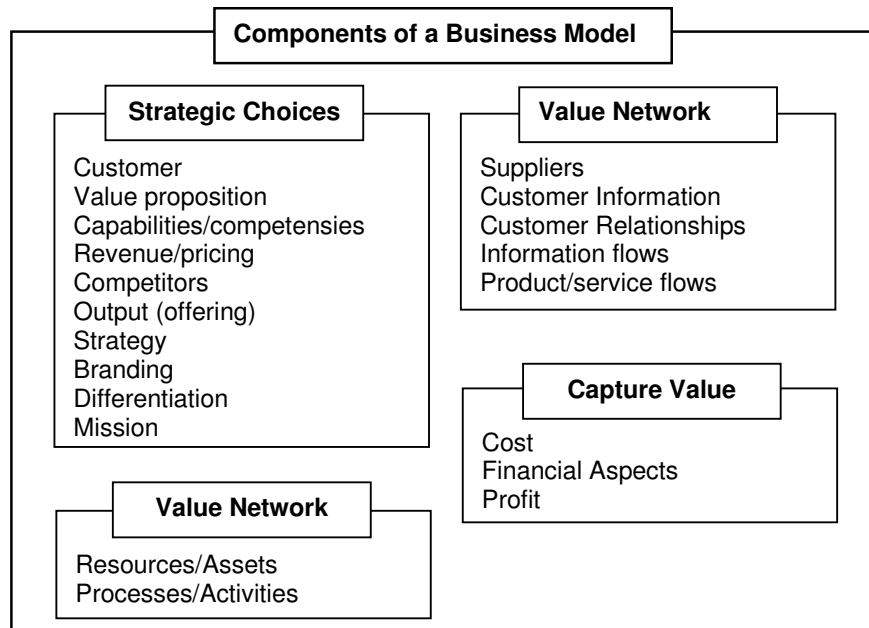


Shane & Venkataraman (2000) also noticed that not all opportunities are exploited. According to these authors, why, when, and how some people successfully exploit some opportunities depends on *the nature of the opportunity*, and *individual differences*. The exploitation of an entrepreneurial opportunity requires *“the entrepreneur to believe that the expected value of the entrepreneurial profit will be large enough to compensate for the opportunity cost of other alternatives (including the loss of leisure), the lack of liquidity of the investment of time and money, and a premium for bearing uncertainty.”* However, sufficient financial returns are not enough as the personal experiences and knowledge of individuals have an effect on the outcome of opportunity exploitation.

## 2.5 Business models

In order to establish a business model for international sourcing we must address the definition of a business model. Drucker (2001) says *business model defines the purpose and mission of a business and enables it to set objectives, develop strategies, concentrate resources, and manage performance specifically from the customers' point of view of.* In essence, a good business model is essential for every successful organization and that it defines who the customer are and what they value. Similarly to Drucker, Magretta (2002) notes that a business model *plans for and explains the underlying economic logic that defines how a business can deliver value to customers at an appropriate cost.* Thus, in practice formulating a business model is the managerial equivalent of the scientific methods; *"you start with a hypothesis, which you then test in action and then revise when necessary."*

Shafer's, Smith's & Linder's study of business model definitions offers a more comprehensive concept that draws it's depth from a wide range of generally accepted definitions. Their study comprised of 12 widely used definitions of business models. These 12 models included 42 different components. From this setting the authors developed component affinity (Figure 3) and ended up in concluding that the term 'business model' can be classified in four categories; *strategic choices, the value network, creating value, and capturing value.* After combining the concepts with the components in the affinity diagram, the authors were able to formulate the following definition for a 'business model': *"Business model is the representation of a firm's underlying core logic and strategic choices for creating and capturing value within a value network."*



**Figure 3:** Components of a business model – affinity diagram  
 Shafer, Smith & Linder (2005)

Magretta (2002) as well as Shafer, Smith & Linder (2005) remind us that the term ‘business model’ is among the most sloppily used and defined term today. It is often used interchangeably with the word ‘strategy’, and furthermore, these words are often stretched to mean everything that has something to do with business and the way it is conducted. However, a business model is not identical to a firm’s strategy. Strategy can be defined in a multitude of ways but despite the definition strategy contains one common element which regards making choices. According to Shafer, Smith & Linder, business model reflects these strategic choices and their operating implications. Therefore a business model *“facilitates the analysis, testing and validation of cause-and-effect relationships that flow from the strategic choices that have been made.”* As a consequence, the organization’s business model is never complete as the process of making strategic choices and testing business models should be constant. In addition and although business models are a powerful tool for firm’s managers, it has its limitations as a business model is only as good as the assumptions underlying the core choices. Flawed strategic choices, assumptions and misunderstanding about the core business logic as well as about the value creation and capture can lead to problems related to business models.

## **2.6 Chinese business environment**

There are a multitude of distinctive characteristics in the way business dealings occur with the Chinese market. Traditionally, the main difficulties between the western countries' and China's interaction have been assigned to the cultural gap among peoples with different histories and customs. The Chinese society's social and relational habits are still inundated by the Confucian ethic which dates back to philosopher Confucius who lived between 551 and 479 BC. The Confucian philosophy condemns individualism, underlining the pursuing of harmony and social peace. This can only be achieved if every individual accepts his or her role in the society, and identifies with the precise dependency of relationships and mutual respect, which has resulted in elaborate consequences on Chinese society's characteristics and values. Therefore, the Chinese society is strongly hierarchical. (Nassimbeni and Sartor, 2006)

The Chinese economy enjoys the highest growth rate in the world while it represents the most challenging offshore market for global sourcing. China's triumph and attractiveness for international sourcing does not only derive from its low labor cost. It is the result of decades of accurate strategic planning with the outcome of a logistic system that is by far better than in any other developing countries. Economists and other scientists are constantly analyzing China's fast economic development and the future potential of this market. Although the sustainability is often questioned, there is one issue of which every one seems to agree on and that remains certain: The cost of labor will continue to remain far below European average for the next 20 years. This indicates that China's attractiveness for sourcing operations will probably continue for another 15 to 20 years before China reaches a satisfactory level of employment in comparison with western levels by around year 2025. (Nassimbeni and Sartor, 2006)

### **2.6.1 Chinese business networks**

The Chinese concept of *guanxi* (connections) has attained a great deal of attention in research and there is a debate on what *guanxi* is, whether *guanxi* is unique to China, what the significance of *guanxi* is, and whether it is declining or not. A complete review of the differences and similarities among various views on this issue is beyond the scope of this article. However, as an imperative aspect of the Chinese business environment some of the related ideas and findings of *guanxi* research are essential to cover.

Chan (2000) notes that despite it is all the time tried, it is quite impossible to define what is typically Chinese. Finding a singular culture in China, let alone in Chinese overseas cultures, is impossible, and the term 'Chinese' is very loose, based on cultural stereotypes and very imprecise. Dunung (1998) says that to some degree all Chinese consider themselves as one big family and outsiders with their foreign cultures and ideas are welcomed, but seldom trusted. Chinese businessmen are often perceived as fortune seekers who are exploitative and business savvy. The idea of Chinese being successful, wealthy and exploitative most probably comes from the historical fact that Chinese were often selected as their colonial masters' middlemen due to the fact that they were politically and religiously less of a threat than the indigenous people (Chan, 2000).

In today's China, the community is divided in three social strata; 1) the political bureaucratic elite, 2) intellectuals and entrepreneurs, and 3) the peasants and workers. The lack of equilibrium in Chinese social economy creates distrust between the entrepreneurs and the modern-day mandarin elite. It is a situation where each group forms their separate networks and tries to advance their own interests. This results in obvious group solidarity, the 'guanxi', which becomes visible as a safeguard against hostile outside conditions. (Chan, 2000)

The term *guanxi* is commonly heard in any Chinese communities, and especially in the business environment. *Guanxi* has been considered as a *special relationship, status, and intensity of preexisting relationship between two or more persons where long term mutual benefit exceeds short term individual gain*. (Chan et al, 2000, 38; Wong & Leung, 2001) *Guanxi* networks are varied; they can be formed on the basis of almost limitless shared social attributes such as kinship, friends, or between strangers with common interest.

There are considerable unwritten codes of conduct with trust that safeguard against opportunistic behavior within the group. Before someone is accepted into the network, their track record and reliability is examined. In the network a violation against the code of conduct is perceived as a violation of trust. Because of the uncoded nature the concept of trust is vague and cumbersome. It takes both official and personal stakes and a timely process to build trust in the Chinese network. However, this can sometimes be circumvented by being introduced into a network. In this case the introducer's trustworthiness is transferred to the person introduced.

It is often concluded that the *guanxi* is the key theme of Chinese business culture. Obtaining introductions and the *guanxi* when doing business in China will ensure attentive audience for business and subsequent interactions. However, the *guanxi* by definition means that there is an element of complex favor included in the business relationship: The *guanxi* creates an interdependency between the two parties; those who have the connections will often try to profit from them and favors are expected to be returned at some time in the future. In reality, there are networks of personal relationships and transactions – networks of *quanxi* – that transfer into a complex network of social exchanges, the '*guanxiwang*'. Thus it has widely been accepted that one needs good personal relationships (*quanxi*) to do business successfully in Chinese business environment. (Dunung, 1998; Chan et al, 2000)

Chan et al (2000) divide *business relations* into two different notions of "personal trust" and "system trust". This notion comes from the idea that in different cultures we have different degrees of trust towards personal and business contacts and towards the prevailing legal system. In simplicity, western cultures have a strong legal system that can be relied on in personal and business dealings. In Chinese culture, legal system and public authorities cannot straightforwardly be trusted and thus the lack of codified system is mended by creating a trusted network, both personally and when doing business. Historically this can be seen for example in the lack of trust towards paper money, which of course is an embodiment of systemic bureaucracy and legal structure. To the Chinese, doing business is a continuous struggle against the mandarin elite and formal institutions are never to be trusted. Therefore in doing business one has to defend their own networks from poor legislation by bonding and trust within the networks. Personal trust is regarded as an

important cultural resource to build business networks, compensating in the lack of availability of a resource to law. (Chan, 2000; Wong & Leung, 2001)

It has to be noted that therein lays a perspective of “trust versus legality” where one could argue that by upholding the importance of personal trust as a specific cultural asset business relations in China are kept from becoming legally formalized and standardized. It could be further argued that the emphasis on personal trust keeps outsiders out and insiders in Chinese business networks and that it helps securing a type of hegemony in the Chinese business culture. This is perhaps a reason why western companies have started to become eager to learn the Chinese way instead of pressing their Chinese business partners to comply with contract law. (Chan, 2000, 18)

In any case, this system of group solidarity and trust is why Interpretation of contracts is somewhat cumbersome in the Chinese business conduct. According to Dunung (1998, 108) problems for foreigners arise mainly because the Chinese version of a contract governs any disputes and because interpretations of the text can differ due to tonal quality of the language. Also, one should notice that in general the Chinese perceive that contracts’ sole purpose is to establish a positive relationship between parties of shared interests that continues and changes indefinitely. Therefore many contracts are written in terms of principles rather than specifics as the underpinning belief is that business is taken care of based on relationships.

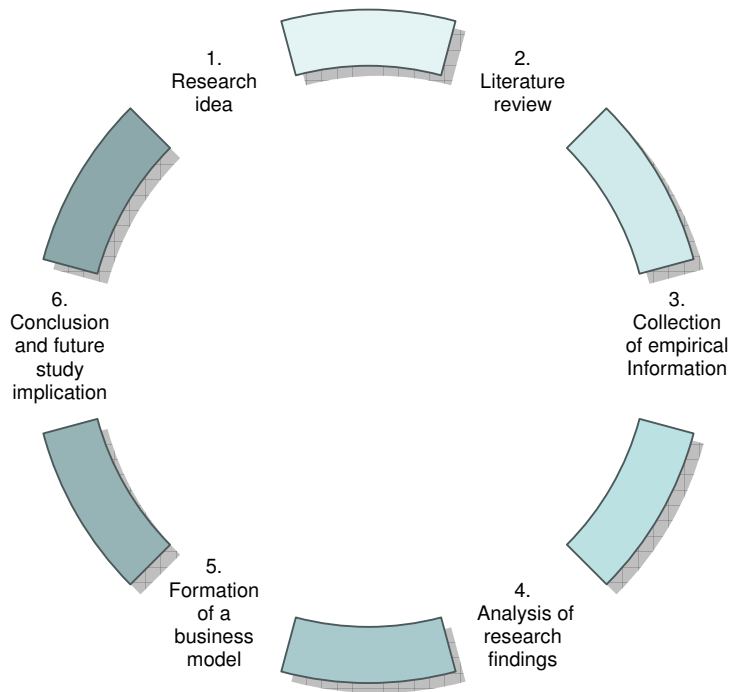
Dunung (1998) also notes that due to the complex and vague structure of Chinese business networks it is often hard for an outsider to determine who has the authority for decision making, particularly in the public sector. Despite the complex structure of state influence and intervention in business endeavors Dunung emphasizes that it is important to remember that China’s main underlying goal is to attract foreign investments into the country in the forms of technology, information, and capital. Therefore it is advisable for the foreign companies to use government resources to monitor changes in policy, priorities, and investment incentives.

### 3. METHODOLOGY

The selection of suitable research methods is a main decision in the research process. Effective methods require that they fit the problem under consideration as well as the presumptions of the researcher. An ideal approach comes as close as possible to the phenomenon in question, aiming to understand it and give answers according to the research's objectives.

The purpose of this research project was to study the significance of the international sourcing intermediaries in relation to western SME's internationalization process. This research paper should also assess underlying potential for an international sourcing company startup that operates as an intermediate between the growing market of Chinese quality suppliers and the Finnish sales- and manufacturing companies. The structure chosen for this research process is summarized in the figure below (Diagram 1).

**Diagram 1: Structure of the research**





The objectives of this research project are to determine answers to the following research questions:

- 1) *What factors have an influence (driving forces) on using international sourcing?*
- 2) *What kind of business model could be derived from these factors to seize the IS opportunity?*
- 3) *What are the critical foreign supplier characteristics for internationalizing SME's?*

The first stage of the study has focused to review the existing literature in relation to international supply sourcing companies in order to establish a theoretical background for the research. The literature review focused on several areas that have a valid relation to the subject; entrepreneurship, international sourcing, internationalization of SME's, business models, business opportunities, building social capital, and business environment of China. This theoretical background research has offered a basis for understanding the objectives and the scope of the study, helped to create a coherent picture of the subject matter, and offered some clear implications for answers to the research questions. These will be discussed in the 'analysis' section.

The following stage of this study is of an exploratory nature: It consists of a survey and interview questionnaire within the Finnish small and medium sized businesses (SME's). This questionnaire was developed with the aim to determine what are the Finnish SME's attitudes and experiences towards foreign suppliers in order to find empirical evidence to support literature review findings. The survey was conducted through an anonymous questionnaire. In order to establish validity for this research and to compare results between two European countries, the survey was partially adapted from a research conducted in Italy in 2005 by Guido Nassimbeni and Marco Sartor. (Tables 1-4; Nassimbeni & Sartor, 2006)

Subsequently to presenting the survey findings, the findings from the literature review as well as from the survey are analyzed thoroughly in the penultimate section of this paper. A business model for the IS intermediate is drawn from these findings and presented accordingly. In the final part of this paper, there are brief concluding remarks, which also include the evaluation of this research's quality, credibility, and confirmability as well as assessment for future research potential.

## 4. SURVEY AND INTERVIEW FINDINGS

The survey sample included five different sized Finnish small and medium sized companies (SME's) that were selected based on their experience on foreign suppliers in different industries. All companies are limited companies whose turnover varies between 500 thousand euros and 5 million euros and their operation strongly involves the use of foreign suppliers. All sample companies are 'buyers', i.e. they are sourcing components or materials for manufacturing, or they are sourcing finished goods for sales in Finland. In addition, the sample includes one international trade intermediary company, which currently acts as an agent between western companies and Chinese suppliers. The inclusion of this agent should give us more insight on the field of IS intermediaries.

The survey form (see appendix 1) was developed to determine what are the Finnish SME's attitudes and experiences on foreign suppliers in order to find empirical evidence to support the literature review findings. In order to establish this research's validity, and to be able to compare results between two European countries, the survey was partially adapted from a research conducted in Italy in 2005 by Guido Nassimbeni and Marco Sartor. Tables 1-4 represent the results of the survey in comparison with Nassimbeni's and Sartor's (2006) survey results among Italian companies. The results define the relevance of IS motivation factors, factors related to negotiations, supplier selection criteria, and factors inhibiting IS.

This research's survey included three interview questions related to *international trade's intermediaries* as well as a set of quantitative multiple-choice questions on selected supplier criteria that trace the average evaluations of *foreign suppliers*. The multiple-choice questions were adapted from the research conducted in Italy, and it follows a 5-point Likert scale scoring, with one equaling not important and five equaling very important. The acquired quantitative data is presented in tables 1-4, which noticeably aid detecting and confirming the SME's predispositions. The results are now presented by dividing them based on the questionnaire's subtopics; 1) factors motivating IS, 2) factors related to negotiations, 3) supplier selection criteria, 4) factors inhibiting IS, and 5) SME's experiences on trade agents and intermediaries.

#### 4.1 IS motivating factors

As seen in the literature review, the search for *lower purchasing costs, the access to new suppliers, increase in the quality and quantity of products* and *access to lower labor cost* are traditionally among the most critical factors for international sourcing. (Nassimbeni & Sartor, 2006; Cheng, 2004)

This study's survey's first part asked respondents to classify a relevance of each of the given factors related to IS motivating factors on a scale of one to five. In the light of the literature research, the answers (Table 1) of survey samples, the Finnish SME's purchasing managers, seem coherent with the theory: There were two notably prominent factors that were clearly at the top of the motives; *the possibility of attaining lower purchasing costs* attained five (mean of 4.7) points from all but one of the respondents, and *the access to suppliers having distinctive capabilities from the domestic market* respectively attained four (mean of 4.2) points from all but one of the responses. The third most relevant factor was *the global competition* with the mean being roughly three points. The rest of the factors obtained less than three relevance points.

**Table 1: Factors motivating IS** (Likert scale of 1-5)

|   | <b>FINLAND</b><br>N=5 | <b>ITALY</b><br>n=10 | $\Delta$ |
|---|-----------------------|----------------------|----------|
| • Possibility of purchasing less expensive products             | 4,7                   | 3,7                  | 1,0      |
| • Possibility of accessing resources not available domestically | 4,2                   | 3,5                  | 0,7      |
| • Global competition  | 3,3                   | 3,2                  | 0,1      |
| • Possibility of accessing advanced technologies                | 2,8                   | 2,7                  | 0,1      |
| • Possibility of accessing less expensive labor                 | 2,8                   | 3,4                  | 0,6      |
| • Possibility of developing presence in foreign markets         | 2,7                   | 2,2                  | 0,5      |
| • Reduction of trade barriers                                   | 2,3                   | 2,6                  | 0,3      |
| • More advantageous taxation                                    | 2,2                   | 1,8                  | 0,4      |

Average  $\Delta$ : 0,5

All in all, and as shown in table one, the results were very similar to the comparison study which was conducted in Italy in 2005. The average variance between this study's results and the Italian's turned out to be only roughly 0.4 points. This suggests that the IS motivating determinants of the Finnish SME's were similar to the SME's of Italy. The only significant difference was that the Finnish companies evaluated the first two factors, *low price* and *access to new resources*, roughly one point higher in relation to the other factors, whereas these two top factors' relevance variety was much more modest in the

Italian companies' answers. This may suggest that in relation to the other factors compared these two distinguish themselves very clearly in the minds of this sample group's participants.

Cost is the key motivation for the whole process of international sourcing development. What is more, the other top factors are commonly attributed to the search of better quality (or technology) and especially of better price/quality ratio.

#### **4.2 Factors related to negotiations**

As shown in the literature, cultural differences and different languages play an important role in international sourcing. Also, the factors related to negotiations and communication with suppliers reflects directly to the factors related to the supplier selection criteria which will be discussed in the next chapter.

As could be expected, in this study's sample group the cultural differences and language problems also rated the highest; *cultural differences* and *miscommunication and language* both averaged roughly four points (Table 2). This is naturally expected, however for some reason the rates are quite clearly higher than those assigned to the same factors by the Italian companies. Possibly this result reflects that in the minds of this survey's subjects these factors possess great significance in relation to IS.

However, the third factor identified in this study was somewhat surprising and deviates from the original study: *Limited authority of the negotiators* also averaged almost four points (mean of 3.8 points). Most probably this is a result of different ways of doing business in different cultures as we are used to the culture of quite fast decision making in Finland. Also, based on the verbal answers expressed in the survey by those who do business with Chinese suppliers, it seems that the respondents have noticed that it is hard to deal, communicate, and get things done with the Chinese. This could be a reflection of the Chinese way of conducting business, which involves as many persons as possible in the decision making in the form of approvals or other such sort of decision power. This is very different from the western approach as in our culture there are usually only one or few decision makers that can approve deals, and it does not take long for negotiators to get this process taken care of. This issue, however, is in congruence with the findings from

literature review where it was reminded several times that the Chinese business conduct is different and one has to be accustomed to it.

The next critical items in negotiations seem to be *differences in conflict handling styles* and *time limitations* with three points. The time limitations has obtained similar appreciation within the Italian sample group, but the conflict handling style has received a much higher score in this study's survey. However, this is probably related to and mostly explained by the communication problems, cultural differences and problems with decision making power which are also perceived higher by this sample group. Perhaps this conveys that the Finnish companies deem all aspects related to culture, business habits, and communication more dire than their Italian contemporaries.

Finally, *dishonesty of the international negotiator*, the *size of negotiation team*, and *geographical separation* with points remained the least significant factors. This evidence supports the notions found in the literature review; in today's global economy international business is becoming more and more of an everyday issue thanks to efficient communications, transportation networks, and availability of goods and services. In this type of open and fairly transparent environment dishonesty does not carry anyone very far, and issues such as geographical separation no more plays a significant role in business. Notably the cultural differences and language problems are rated high, as suggested by many of the authors' work that was covered in the literature review. Therefore, it could be argued that the SME's international sourcing's problems are most notably related to *miscommunication and language*, and they are followed by the *time limitations* and *cultural differences* and *limited authority of the negotiator*. This argument can be further supported by a comparison to the Italian study; the average variation for negotiations criteria between these two studies is merely 0.8 points.

**Table 2: Factors critical for negotiations** (Likert scale of 1-5)

|  | <b>FINLAND</b> | <b>ITALY</b> |     |
|--|----------------|--------------|-----|
|  | N=5            | n=10         | Δ   |
| • Cultural differences                       | 4,2            | 2,7          | 1,5 |
| • Miscommunication & language                | 4,0            | 3,0          | 1,0 |
| • Limited authority of the negotiator        | 3,8            | 2,6          | 1,2 |
| • Differences in conflict handling styles    | 3,2            | 2,1          | 1,1 |
| • Time limitations                           | 3,0            | 2,7          | 0,3 |
| • Dishonesty of the international negotiator | 2,8            | 2,5          | 0,3 |
| • Size of negotiation team                   | 2,3            | 1,5          | 0,8 |
| • Geographical separation                    | 2,2            | 2,3          | 0,1 |

Average Δ: 0,8

### 4.3 Supplier selection criteria

As it has been noted in the literature review section partner selection - including supplier selection - is considered one of the most critical functions of international business. There are several reasons for this, as explained in the literature review section, and the following findings further support this notion.

The most interesting issue is pointed out by the fact that *the price* was only identified as the fourth most important aspect of supplier selection in this research's survey (Table 3). This clearly states the same notion that has been explained in the past research; although price is important, especially as a driving force of IS, it is not the most important factor to be considered. The three most important factors were *suitable quality of the products*, *meeting of required specifications*, and *punctuality of delivery* which all were assigned very high value that set their mean around 4.5 points. This further proves that suitable quality, punctuality or adequate technical design capabilities are the most critical factors to consider in IS process. Low price remains as one of the main factors but it must not be self-explanatory by itself: The products' quality and price ratio have to maintain a delicate equilibrium in order to maintain reasonably good reputation towards clients. This clearly points out the fact that although low price is one of the main drivers for internationalization and international procurement these type of operations in question cannot be executed at the expense of suitable quality, punctuality or adequate technical design.

The following three factors identified are *technical assistance after sales*, and *proper technological capabilities* which have attained a mean score of four points (4.0 and 3.8 respectively). This yet again proves that the purchase of any given product or material must be considered from the point of view of quality to price ratio, rather than net price. The next item in the results turned out to be the *economic-financial reliability of the supplier* with 3.5 points. This is perhaps somewhat self-explanatory as it is surely important to use suppliers that are stable and not in any ways prone to economic difficulties or production fluctuations due to financial issues. As pointed out above, the western SME's need to make sure they are getting exactly what they want, and therefore it is important that the suppliers possess adequate operational stability. Understandably, a

supplier whose operations are in any way not stable could bring about problems and liabilities to its buyers.

The following factors identified were *large products range, design capability, and terms of payment received* which all received a mean of roughly three points each, while the *manufacturing specialization, flexibility with volumes, exclusive commitment, and geographical proximity* were among the least important factors with scores of less than three points. It has to be noted here, that the variances between these important supplier selection factors in comparison to those of the Italian results are very low, and the average variance adds up to 0.4 points. This level of variance is very low and it can be therefore argued that the experiences and attitudes of the Italian and the Finnish SME's are practically identical.

**Table 3: Supplier selection criteria** (Likert scale of 1-5)

|   | <b>FINLAND</b> | <b>ITALY</b> |                        |
|---|----------------|--------------|------------------------|
|   | N=5            | n=10         | $\Delta$               |
| • Suitable quality of the product       | 4,7            | 4,5          | 0,2                    |
| • Meeting of required specifications    | 4,5            | 4,4          | 0,1                    |
| • Punctuality of delivery               | 4,5            | 4,6          | 0,1                    |
| • Price                                 | 4,2            | 4,2          | 0                      |
| • Technical assistance after sales      | 4,0            | 3,7          | 0,3                    |
| • Proper technological capabilities     | 3,8            | 3,9          | 0,1                    |
| • Economic-Financial reliability        | 3,5            | 3,9          | 0,4                    |
| • Large products range                  | 3,2            | 3,1          | 0,1                    |
| • Design capability                     | 3,2            | 3,3          | 0,1                    |
| • Terms of Payment                      | 3,2            | 3,7          | 0,5                    |
| • Manufacturing specialization          | 3,0            | 3,9          | 0,9                    |
| • Flexibility with reference to volumes | 2,8            | 3,9          | 1,1                    |
| • Exclusive commitment                  | 2,2            | 2,4          | 0,2                    |
| • Geographical proximity                | 2,0            | 3,3          | 1,3                    |
|   |                |              | Average $\Delta$ : 0,4 |

#### 4.4 IS inhibiting factors

The three top factors that are perceived as hindering IS operations are heavily related to culture and communication based reasons (Table 4): *Lack of direct communication* is the number one, *difficulties in having a reliable relationship with foreign suppliers* is second, and *cultural and language differences* third most important aspect of the inhibiting factors. These factors were assigned a mean score of roughly four points (4.0, 3.8, and 3.7 respectively). Now it seems even more apparent that the Finnish SME's find the differences between two cultures to be very critical. These results are further supported in the following chapter with the discussion of the interview questions on international agents and other trade intermediaries.

In turn, the fourth factor is somewhat what could be expected. *Difficulties in valuating the foreign supplier capabilities* was assigned a mean of 3.5 points. This depicts the fact that SME's perceive it hard as well as resource and time consuming to cope directly with the Chinese. Actually, the above mentioned issue can be linked to the limited resources of the SME's because if they had the resources to hire local personnel on the manufacturing site, the importance of this factor would be greatly reduced. The fact that this issue creates problems for the SME's constitutes without a doubt a source of opportunities for the IS intermediary.

Contrary to the Italian study, the Finnish SME's did not consider *difficulties in managing logistics* to be very critical as it was only the fifth important with a fairly low score in relation to the factors on the top of the list. Perhaps surprisingly the Italian study concluded that the number one obstacle for international sourcing were the *difficulties in managing logistics*. This is a contradicting factor to findings of literature review, as it has been identified that out of all developing countries China has excelled in logistics development. The high score of logistics problems could be understandable if the Italian SME's have included possible errors in the Chinese production under logistics responsibilities. As discussed before, the management of quality and technical aspects can be cumbersome with the Chinese.



The last three factors, *exchange rate instability/flexibility*, *customs barriers*, and *political instability of foreign countries* each received a score of around 2.5 points which shows that while these aspects are something to keep in mind they are probably not the first factors to create problems. To sum up, all of the factors in this research's sample group, except customs barriers, received a higher mark relative to the Italians' results. This could mean that these Finnish companies are less experienced and established in the foreign markets. However, the average variance between this study and the Italian was again merely 0.6 points which does not constitute a very significant difference.

**Table 4: IS inhibiting factors** (Likert scale of 1-5)

|   | <b>FINLAND</b><br>N=5 | <b>ITALY</b><br>n=10 | $\Delta$               |
|---|-----------------------|----------------------|------------------------|
| • Lack of direct communication  | 4,0                   | 2,5                  | 1,5                    |
| • Difficulties in having a reliable relationship with foreign suppliers | 3,8                   | 2,8                  | 1,0                    |
| • Cultural and language differences                                     | 3,7                   | 2,6                  | 1,1                    |
| • Difficulties in valuating the foreign supplier capabilities           | 3,5                   | 3,0                  | 0,5                    |
| • Difficulties in managing logistics                                    | 2,8                   | 3,1                  | 0,3                    |
| • Political instability of foreign countries                            | 2,7                   | 2,3                  | 0,4                    |
| • Exchange rate instability/flexibility                                 | 2,5                   | 2,4                  | 0,1                    |
| • Customs barriers  | 2,2                   | 2,3                  | 0,1                    |
|   |                       |                      | Average $\Delta$ : 0,6 |

#### 4.5 SME's experiences on trade agents and intermediaries

These questions were used to track the SME's experiences and expectations on *international trade agents and intermediaries*. The survey sample group's individuals were asked to answer verbally based on their individual expectations and/or experiences to three questions. The results are presented each question at a time.

*Question 1: Have you used intermediaries or agents in your import/procurement activities? What were your experiences, positive or negative?*

All of the Finnish SME's (n=5) answered this question, and the international intermediary company omitted this question due to the fact that this question was obviously not applicable to them. Out of these five three had used intermediaries in their procurement activities from international suppliers. The two that had not used intermediaries were highly specialized on a narrow product segment and reported that they do not need an

intermediary because they have been buying constantly the same things from same foreign suppliers for a many years. Out of the three replies that had used an agent two companies were using them on a regular basis and were very satisfied. The third company had tried an agent once but was not satisfied because they realized that since they had already been doing business directly with Chinese suppliers very successfully there was no reason to take a step back and bring an agent in between.

*Question 2: Why do you use intermediaries or why do you not?*

The two firms that use agents regularly provided somewhat interesting answers. The bottom line of the answers was that agents save these firms' own efforts, time and money as the agent handles everything up until when the goods arrive to the Finnish port. Both firms said that their agents handle procurement, quality inspections and transportation to Finland for them with a reliable service, good price and quality. Both companies also had established a long-term relationship with their foreign agents and they identified that it gives them a sense of trust which makes it easier to concentrate on their own operations. If these companies did not use an agent they would end up paying a lot more than what the agent charges. Therefore the agent actually saves them money. Furthermore, it was reported that the agents are very efficient in what they do because of their specialization and because they are very well connected to suppliers and logistics companies within their market. An important aspect related to communication with the Chinese suppliers came up with three of the interviewed firms: It seems to be often quite frustrating for the Finnish SME's to communicate with the Chinese.

The three companies which said that they are not using agents did not do so because they were experienced in doing business abroad. With all three companies this international procurement had initially involved the prolonged efforts of the entrepreneurs who were after many years of practice capable of handling supplier relations by themselves. In essence, by time they have found suppliers they can trust and now they have no reason to change the situation. Therefore they did not feel they needed to use an intermediary.

The remarks of the trade agent who operates internationally from China were very insightful. They said that western companies use them mainly to screen and to visit the Chinese factories before ordering. Apparently most firms understand that it is important to

do company visits to the factory and to get to know the Chinese before doing business. A very great deal of this, in accordance to the Chinese culture, involves informal meetings and dinners. Many of the western companies do not have the resources, time or skills to perform these activities, and they know that by using an experienced agent the total cost of procurement is lower even if intermediation cost is included. According to the agent, their competitive advantage is that they know how to deal with the Chinese; the Chinese and the western customer need them in the middle because they make it all work without very high cost. The western customers perceive the intermediary as a money and resource saving partner.

It has to be noted that two of the interviewed companies were doing business with the Chinese, one independently and one with an intermediary. However, the interesting side of this is that both companies deemed that communication required quite a lot of effort because of cultural differences. Also, the companies that were dealing with other nations did not mention the problems related to communication verbally, but they scored these problems among the highest with the multiple-choice questions. It is therefore reasonable to assume that the Finns perceive the cultural differences and communication troublesome.

*Question 3: What characteristics would you expect from your international trade intermediary?*

The number one driver identified for the usage of agents and intermediaries was *low or reasonable price* which was mentioned by all of the respondents (100%). The main reasoning behind this statement was that an agent is expected to save money because an agent should be able to handle supplier relations and procurement for significantly lower cost in relation to its customers. Therefore they are able to transfer the low cost of product to the customers with some but fairly low added intermediation cost.

However, although it was most frequently mentioned, several of the answers stated that low price is not the most important aspect. Thus, although price is the key driver for using intermediaries, it is a secondary factor in comparison to *punctuality*, *reliability (trustworthiness)*, and *high quality of products* which all were mentioned by five out of six respondents (83%). Also, at least two of these three qualities were mentioned by all of the

respondents. These issues were notably related to sense of maintaining continuous operations as well as intact reputation. Any trouble in relation to punctuality, reliability, and quality could mean direct losses or that the company will have to pay for mistakes later.

Finally, two more common required aspects from an intermediary included *ease of doing international business*, which was identified by 50% of the respondents, together with *open and regular communication*, which was mentioned by one third (33%).

## 5. ANALYSIS

The main purpose of this study was set to address the significance of the international sourcing (IS) intermediaries in relation to western SME's internationalization process. The underpinning purpose of this research paper is to assess underlying potential for a Finland-based IS company that operates as an intermediate between the growing market of Chinese quality suppliers and the Finnish sales- and manufacturing companies.

The objectives of this research project are to determine answers to the following research questions:

- 1) *What factors have an influence on using international sourcing (IS), i.e. what are the driving forces of using IS?*
- 2) *What type of IS opportunities could be derived from these factors, and what kind of business model could seize it?*
- 3) *What are the critical foreign supplier characteristics for internationalizing SME's?*

The following diagram (Diagram 2) depicts a framework of logic for international sourcing that derives from these research questions. First of all, the research questions express the underpinning assumption that an entrepreneurial *opportunity* exists for the type of IS intermediate in question. Secondly, this opportunity can be identified by examining the *driving forces of IS*, and by determining what factors have an influence on using international sourcing. Thirdly, in order to build an IS intermediate's business model that corresponds to the IS opportunities as well as to the driving forces of IS it needs to be determined what are the *critical functions for an IS company*. This framework will be used extensively throughout the analysis section and a full breakdown of its components is introduced in a more elaborate detail.

**Diagram 2: Framework of logic for IS**



## 5.1 Analysis of research findings and their implications

### 5.1.1 Driving Forces of IS

Based on the literature review's findings as well as on the survey's findings the following framework has been formed for the 'Driving Forces' of international sourcing (diagram 3). It appears that the western SME's' motivations towards using IS pertain several perspectives which are most notably related to *globalization and global competition, lack of resources for internationalization operations, as well as the trend of rising use of IS in the global economy.*

Most companies have to compete on some type of global scale whether they want to or not. To compete in the prevailing global economy western companies are facing the problem of how to source the world's best suppliers and how to capture the best opportunities. Locally operating companies have to shift from dealing with local operators into dealing with different cultures, laws, practices, and people. In the modern global economy offshore sourcing is no longer only the strategy for a few large companies but it is the common contribution to any company's competitiveness and survival. (Nassimbeni & Sartor, 2006; Niemelä, 2002; Kirby & Kaiser, 2003; Chung, 2004; Beekman & Robinson, 2004) Because of this, the western companies are constantly looking for *reduction of purchasing costs, access to new type of resources or capabilities, and possibilities of increasing the number of suppliers and products available.* Often for the western SME's these factors force them to take the first steps on a path of internationalization. The empirical evidences from this research's survey as well as from Nassimbeni & Sartor (2006) support the suggestion that lower costs are the number one driver for international endeavors.

However, the western small- and medium sized companies (SME's) often *lack the resources necessary to internationalize* and are therefore reluctant to initiate such an endeavor. The challenges quite often involve limitations such as resource constraints, insufficient knowledge and skills in internationalization. Also different foreign market conditions from domestic market make it hard for a small firm to enter a new market as it requires a larger effort than starting up operations in a familiar environment. (Kirby & Kaiser, 2003; Varis, Kuivalainen and Saarenketo, 2005; Zuchella, 2007; Blomstermo &

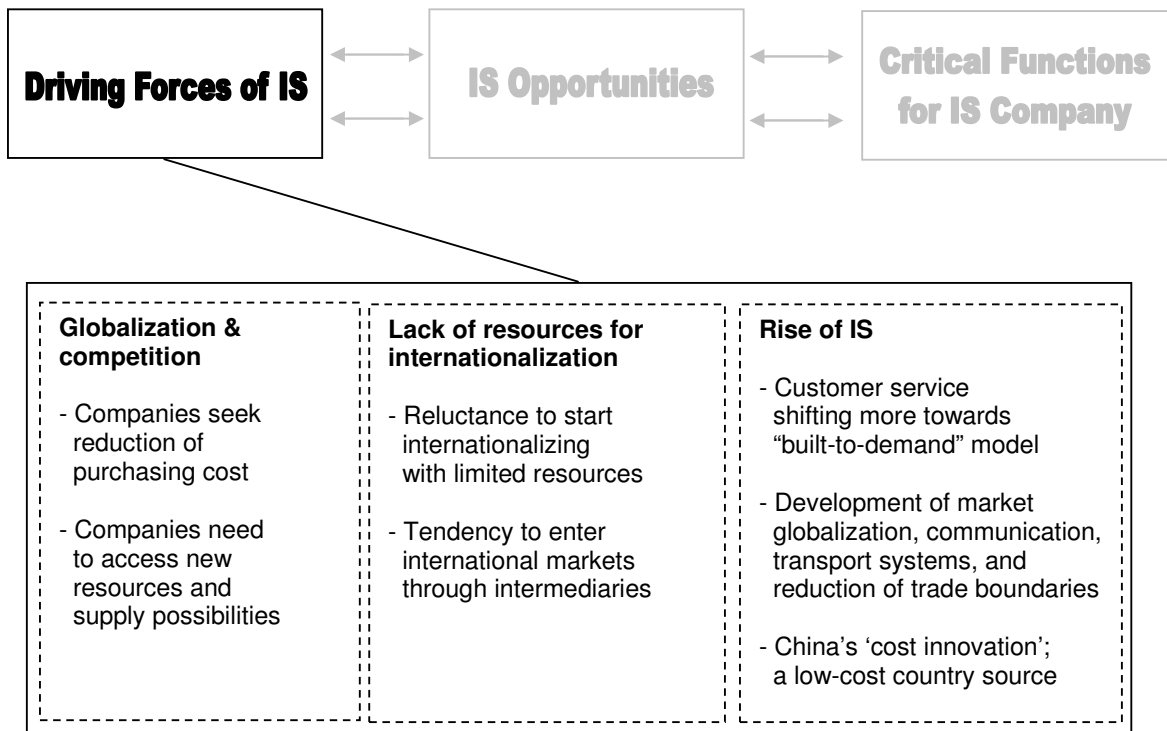
Sharma & al., 2003) With limited resources, it is beneficial to utilize knowledge from other firms, organizations and individuals. Therefore, companies that lack resources for independent IS *tend to enter and explore international supply markets through specialized intermediaries*, agents and distributors thus transferring the responsibility for negotiation and management of the supply relationship to the intermediaries. This is less risky and simpler to a company that is starting up an IS process. However, the purchasing costs will also be higher and the lack of control may have both pros and cons as solutions provided by a third party may not be the best for the company that refers to an intermediary. Intermediation can be a relatively effective and safe way to test the Chinese market before beginning to source directly. Intermediation has shown to be especially effective for two activities; for negotiations, and for monitoring the execution of the technical specifications.

Manufacturers and sellers are under pressure from customers to move away from the traditional “make-to-stock” production model to “build-to-demand” customer service model. In addition, *international sourcing (IS) thrives from the development of market globalization, communication technology, and transport systems, as well as from the reduction of international trade boundaries*. These are all issues which have recently developed enormously in the Chinese market making it one of the most attractive low cost sourcing markets. The Chinese market offers e.g. *low costs with increased quality and quantity of products, but also long-term flexibility in production, lower capital costs, and favorable tax structures*. (Chung, 2004; Nassimbeni and Sartor, 2006 & 2007)

The Chinese economy has enjoyed the highest growth rate in the world which does not only derive from its low labor cost. It is the result of decades of accurate strategic planning with the outcome of a logistic system that is by far better than in any other developing countries. There is no more room for attitudes that take Chinese production as the cheap, low-quality imitations that flood the world markets. On the contrary, the Chinese are excelling in terms of ‘*cost innovation*’, the strategy of using their cost advantage in radically new ways to offer more for less to the end users around the world. ‘Cost innovation’ pertains that Chinese manufacturers are now offering 1) high technology at low cost, 2) unmatched range of products for customers’ choosing in markets that used to be considered standardized, and 3) specialty products by turning them into volume businesses with their low cost advantage. In essence, managers have to accept that China is a source of high technology, variety, and specialist offerings at low cost that can help to

improve global competitiveness. This offers a new trend, and opportunity, in the market for the IS intermediate.

**Diagram 3: ‘Driving Forces’ of IS**



### 5.1.2 IS opportunities

Opportunities are created by observing the existing gaps, new trends, sudden changes, or new necessities in the business environment. Major factor that influences the core process of opportunity recognition is knowledge and experience on the market. In essence, the western SME’s utilization of IS can create opportunities for an IS intermediate. Based on the literature review’s findings as well as on the survey’s findings the following framework has been formed for the ‘IS Opportunities’. It seems that the emergence of IS opportunities are facilitated most notably by *the ‘Driving Forces’ of IS, the entrepreneurs’ alertness, knowledge, and experience on the market, as well as the IS company’s existing assets* (Diagram 4).



It was noted in literature review that innovation process leads to creative destruction, and temporary monopolies in any number of these ways: 1) Introduction of new product or a new quality of an old product. 2) Introduction of new method of production. 3) Opening of a new market. 4) Introduction of a new source of supply. 5) Introduction of a new organization. Therefore innovativeness is a critical source for value creation, and that innovations have a great influence on companies' entrepreneurial and organizational behavior, growth possibilities, opportunities, business structures, strategies, processes, and products. (Schumpeter, 1934; Drucker, 1985; Shane & Venkataraman, 2000; Baron & Markman, 2003) Also, innovations do not occur by themselves but rather they are the results of intentional entrepreneurial processes related to opportunity development. (Ardichvili, Cardozo & Ray, 2003; Baron and Markman, 2003) Opportunity identification and development requires knowledge and experience of the market. Ardichvili, Cardozo & Ray (2003) say that in the simplest form opportunity is imprecisely defined market need, under-employed resource, or combination of these two which leads to value creation.

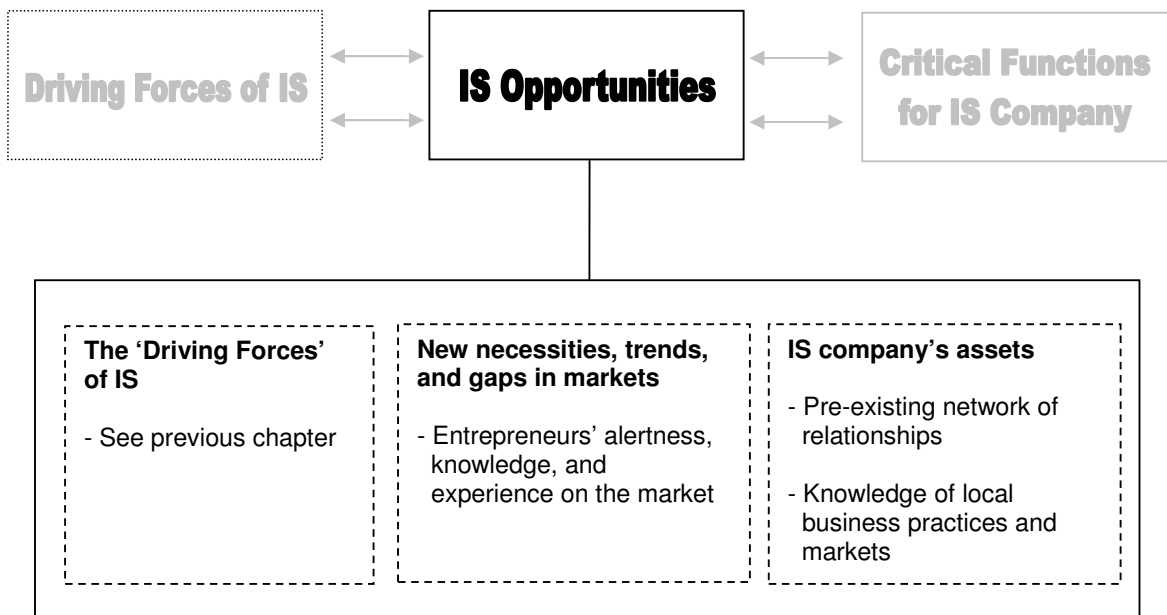
Therefore it can be suggested that *the IS opportunities can be created or discovered and seized if the entrepreneur with his knowledge and experience of the market finds that there are existing gaps, new trends, sudden changes, or new necessities in the market.*

As discussed in the previous chapter, there are several driving forces of S in the global market that are pointing the western SME's' interests towards the Chinese market. The above discussed driving forces *offer an opportunity in the form of new necessity, trend, and gap in the sourcing market for the IS intermediate.*

In practice, there are numerous modes of internationalization that any firm may choose from when looking into starting up an internationalization process. *The role of intermediaries is especially relevant in the initial stages of internationalization* because Intermediaries can be especially effective in partner selection which is regarded as one of the most crucial tasks in internationalization. (Nassimbeni and Sartor, 2006; Nijssen, Douglas & Calis, 1997; Kirby and Kaiser, 2003; Beekman and Robinson, 2004; Varis, Kuivalainen and Saarenketo, 2005) This offers a new necessity, and opportunity, in the market for the IS intermediate.

The main assets of the IS company lie in their pre-existing network of relationships and knowledge of local business practices and markets. Therefore, intermediation can be a relatively effective and safe way for western SME's to test the Chinese market before beginning to source directly.

**Diagram 4: IS Opportunities**



One of the objectives of this research project was to define a business model to facilitate the seizing of these IS opportunities. The suggested business model will be discussed in detail in a subsequent section of this paper.

### 5.1.3 Critical characteristics for IS company

Based on the previous findings the following framework has been formed for the critical functions for the IS company: It seems that the international sourcing company's functions have to be examined from three perspectives; the entrepreneur's, the IS company's, and the Finnish SME's'. (Diagram 5) It appears that certain entrepreneurial activities as well as IS company's activities are required to offer added value for the Finnish SME's ('Driving Forces of IS' mentioned in the previous chapter). Many of these requirements can be related to social capital which seems to accumulate from the activities of the entrepreneur onwards to the IS company and from there onwards to the Finnish SME's.

Entrepreneurship involves the gathering of resources which are usually obtained through the entrepreneur's *personal network*. Essentially networks connect the entrepreneur with opportunities critical to a firm's success, facilitate innovation, spread risks, and provide support, credibility, and contacts. Building an international value-network for a firm calls for constant proactive evaluation with company-specific criteria of both the existing network as well as potential partners. The key factor in satisfactory partner selection seems again to be the management's proactiveness in the search process. Especially in the case of international new ventures (INV) or 'born globals', entrepreneurs have to use strategic alliances and networks as a way to overcome the usual lack of resources. Successful INV entrepreneurs must be adept with international networks because this helps focus on identifying and utilizing scattered opportunities that others do not see.

Networking allows internationalizing SME's to complement each others' knowledge and skills, and specialization. Successful international ventures call for entrepreneurial international attitude, orientation, skills, experience, and networks as well as market knowledge and commitment. In essence, entrepreneurs can gain access to new markets and to complementary skills and assets by networking. In addition, networking can allow companies to overcome the 'liability of newness': As new firms typically lack company identity, brand name, and legitimacy it is difficult for them to enter exchange relationships as their credibility, promises, and staying power are easily questioned. They can be compensated by a strong person-based credibility with entrepreneur's personal network,

social capital, and social skills. (Niemelä, 2002; Ostgaard & Birley, 1996; Smith & Lohrke, 2008; De Carolis, Litzky and Eddleston, 2009)

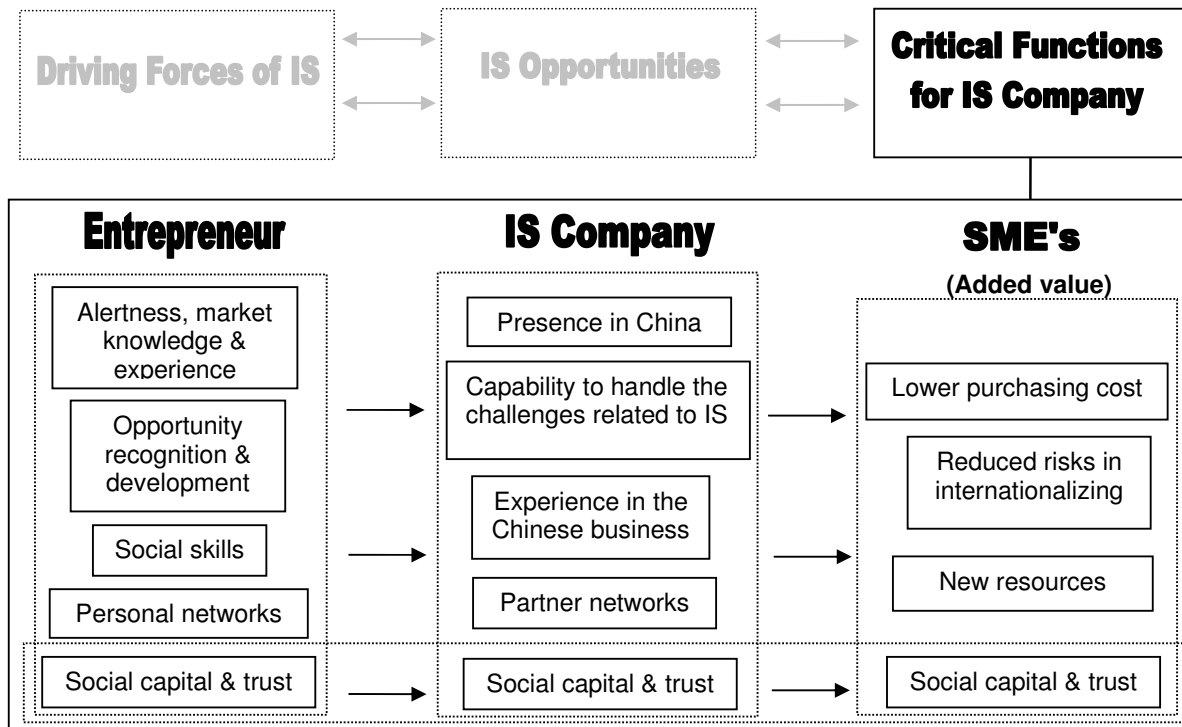
Networking is strongly tied to social *capital and trust*. Social capital is defined as the combination of exchange of intellectual capital in network of relationships of an entrepreneur or a company, and it *plays a crucial role in creation of innovations as well as in entrepreneurial success*. Because social competence plays an important role in building social capital, entrepreneurs who are socially adept and possess high levels of social capital are more likely to be able to find financial resources. Researchers seem to agree that *social capital and trust are crucial because in global competition one cannot survive without some type of international collaboration and alliances*, and that the single most important aspect of international collaboration falls down to trust. Therefore, it is important that managers intentionally lead the process of developing trust, which usually involves deliberate investments of time, funds, infrastructure and people. Managers have to pay attention to the essential dynamics of trust discussed in the literature review. In essence, trust facilitates social exchange, and reduces the need for monitoring. Therefore time and resources can be assigned to more beneficial operations and endeavors. (Nahapiet & Ghoshal, 1998; Dakhli & De Clercq, 2004; Parkhe's, 1998)

The above mentioned qualities aid in confronting *IS related challenges* that have arisen in China, such as *cultural and communication barriers, longer supplying lead times, higher transport costs, difficulties in handling logistics, quality issues, risks linked to business transactions with different contact people and different regulations*. Companies also need to consider *longer start-up time of operations, weak intellectual property protection, increased management complexity, as well as energy shortages and other operational hiccups*. However, the real problems with IS in China appear when the buyer has to decide where to buy, as well as when the buyer has to analyze the risk of the operation: It is crucial to be able to identify the right partners. (Nassimbeni and Sartor, 2006; Kirby & Kaiser, 2003; Cheng, 2004) When sourcing from China one needs to think about total landed cost, and that the product matches the needs. It must not be self-explanatory just to have something manufactured at low cost.

Due to the above mentioned distinctive attributes of the Chinese market, an operator on this market has to *be experienced in the Chinese business environment as well as to possess a physical presence in the Chinese market*. In other words, one has to be able to actively navigate the requirements between western and Chinese companies to manage and maintain successful business relationship. The main difficulties between the western countries' and China's interaction have been assigned to the cultural gap among peoples with different histories and customs. Other relevant issues include at least the society's social and relational habits (*guanxi*), the societal and political environment, and the differences in interpretation of contracts. For example, due to poor legislation and juridical protection companies and individuals tend to develop bonding and trust within their networks. Reliance to legality and contracts like in the western system does not apply in the Chinese market. The experience and familiarity on the Chinese business environment's characteristics discussed in the literature review section is a necessary quality for a sourcing intermediate operating on this market.

The creation of successful business is the result of a successful opportunity development process which includes recognition of the opportunity, its evaluation, and development. Opportunity identification and development always requires *knowledge and experience of the market*. Some major factors that influence the core process of opportunity recognition are *entrepreneurial alertness, prior knowledge, and social networks*. These features remain the crucial features for the IS intermediate and the IS entrepreneur. Thus, the entrepreneur's personal experiences and market forecasts based on market research combined together form a combination that facilitates opportunity identification. Also, conscious acts of recognizing and pursuing opportunities consistently makes people and firms more opportunity aware and thus speeds the process of opportunities identification. (Schindehutte, Morris & Pitt; 2009; Baron, 2006; Ardichvili, Cardozo & Ray, 2003)

**Diagram 5: Critical functions for IS**

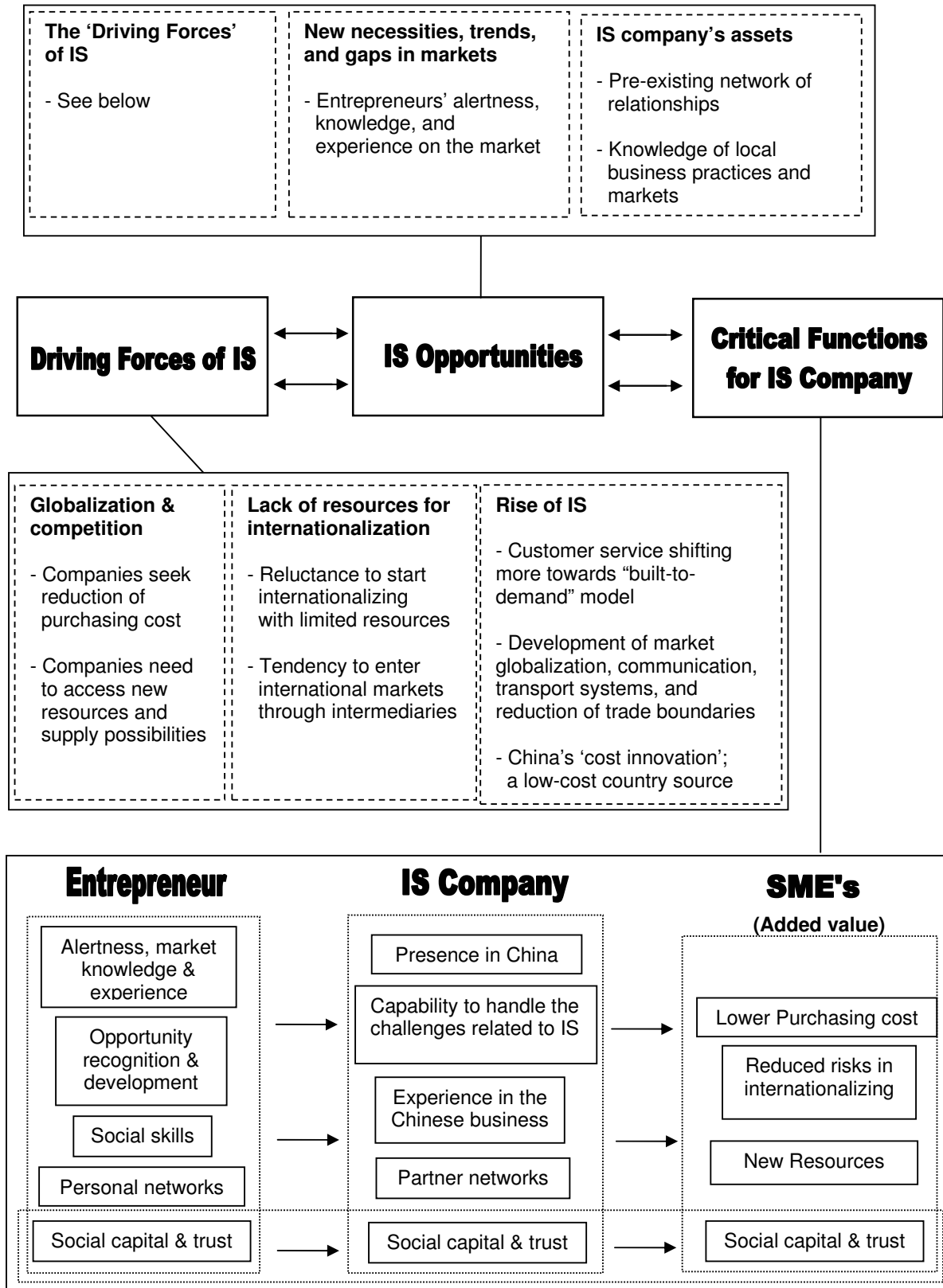


## 5.2 Suggested business model

Drucker (2001) says *business model defines the purpose and mission of a business and enables it to set objectives, develop strategies, concentrate resources, and manage performance specifically from the customers' point of view of*. Shafer, Smith & Linder (2005) say that *business model is the representation of a firm's underlying core logic and strategic choices for creating and capturing value within a value network*.

In this chapter, the original business model framework provided by Shafer, Smith & Linder (Figure 3, p. 34), which was introduced in the literature review section, and the 'framework of logic for IS' full breakdown (Diagram 6) will be used to formulate a cohesive business model for an IS intermediate.

**Diagram 6: Framework of logic for IS, full breakdown**



The framework of logic for IS (Diagram 6) formulated and discussed in previous chapter offers our business model a comprehensive set of important aspects. The 'Driving Forces of IS' as well as the 'IS Opportunities' provide the IS company and the entrepreneur some underlying insight on *why* to do business in the field of international sourcing. On the other hand, the 'Critical Functions of IS Company' explains the key aspects of *how* to do business within this market. It is important to notice that the critical functions are divided in three categories; the entrepreneur's, the IS company's, and the SME's' as each of them posses distinct aspects and processes that need to be fulfilled at all times in order to create a successful IS intermediate operation. Also, the 'critical functions' are not a comprehensive process as such, but instead they involve a set of distinct always ongoing processes and features that need to be covered by the IS business model. Because of this, the framework of logic is an important base for understanding and knowledge in order to formulate the IS business model.

Shafer's, Smith's & Linder's (2005) said that 'business model' can be classified in four categories; *strategic choices, the value network, creating value, and capturing value*. The following IS intermediate business model draws its foundation from this definition.

The *strategic choices* of the international sourcing company will firstly involve the selection of a *mission* that sets the direction for the overall business. As it has been discussed throughout this paper, there is a prominent *target market* or group of *customers* for this intermediate; the western SME's who possess limited resources for internationalization and who are facing the challenges of globalization. Therefore, *the mission of the new IS intermediate is to help the western SME's to overcome their limitations, liabilities, and obstacles in relation to global competition and internationalization by assisting them in international sourcing operations*.

The *value proposition and offering* (added value) for the IS intermediate's customer derives from the 'driving forces of IS'. The IS intermediate can offer the western SME's the ability to tap in to *lower production costs, to new resources and supply possibilities* while maintaining *lower level of risk* in relation to this internationalization process. These services can occur for example in the form of such activities as supplier screening, assessment and selection, management of production and transportation, as well as quality controlling. The IS intermediate can offer these services to its customers because it

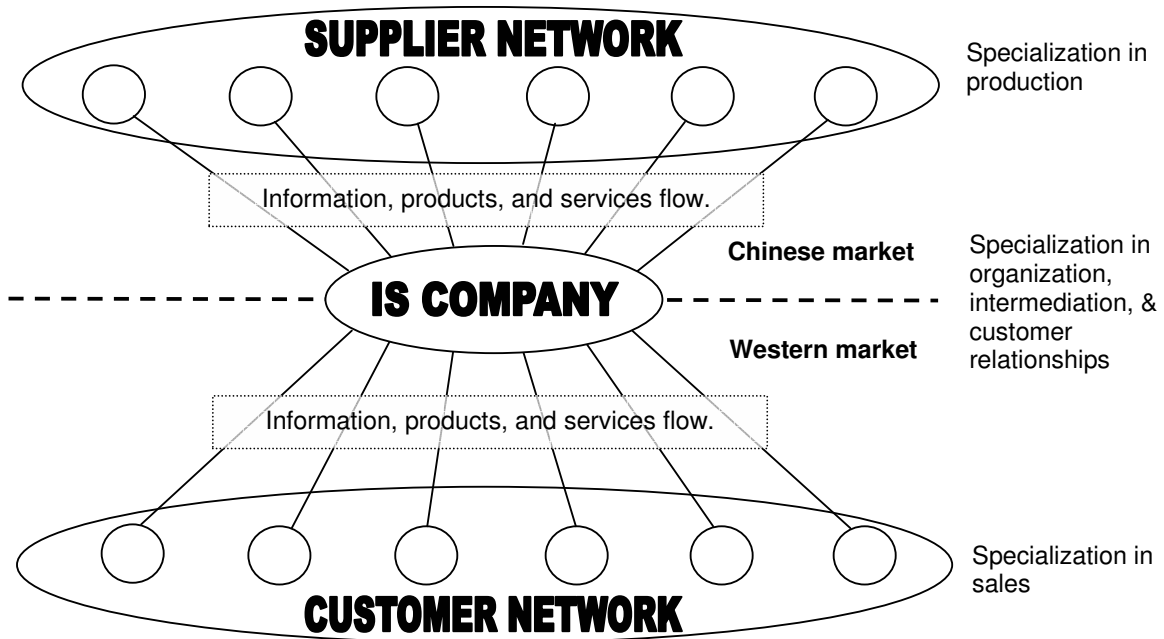


possesses distinctive *assets, capabilities and competences*, which must include a combination of *strong presence in China and experience in doing business in China, the pre-existing networks of relationships and partners* for both the IS company and the entrepreneur, *the capability to handle IS challenges*, as well as *knowledge and experience on the market, and entrepreneurial alertness to opportunities*. These qualities are essentially the key factors with which the IS company can offer its value proposition to the western SME's.

Furthermore, for any company to be successful it has to generate adequate streams of *revenue*. The revenue for the IS intermediate will only accumulate when it can offer its service of supplier sourcing and management with *better efficiency and/or lower cost* than what would incur if the western SME's were to take care of the process themselves. This factor should be provided for with the above discussed assets of the IS company: If the IS intermediate is capable and efficient in operating with the Chinese suppliers it is very hard for the western customers to overcome its efficiency and to overcome the necessity and justification of using the intermediate in the supply chain. The IS intermediate can set its revenues and pricing based on the cost savings that it is generating to its customers: As long as it is helping the customers to save money they will gladly pay the price for it.

The overall *value network* (Diagram 7.) of the IS intermediate consists of the suppliers in China as well as of the customers that are the western SME's. The key task for the IS company is to operate as an *networking hub* that builds the *networks of suppliers and customers* in order to facilitate successful *relationships, information flow, as well as product and/or service flows*. This structure of the value network is very important as the research findings implicate that the most critical factors for international sourcing are *punctuality, reliability (trustworthiness), and high quality of products*. Therefore the IS intermediate operates in between the Chinese suppliers and western SME's as an organizer of all related processes. This structure solves the problems related to various resources constraints for the SME's, and the problem of reaching western customers for the Chinese suppliers. In essence, the activities of the networking IS intermediate must ensure the accumulation of *social capital* within the network. Notice that to *capture value* this type of international IS intermediate cannot operate in the western market alone as it is crucial to possess a strong professional presence in the Chinese market too.

**Diagram 7:** Value network for international sourcing



## 6. CONCLUSION

This study has contributed both theoretically and empirically to the knowledge of international sourcing, which currently is a somewhat modestly researched academic area. The purpose of this study was set to address the significance of the international sourcing (IS) intermediaries in relation to western SME's internationalization process. The underlying purpose and motivation for the research was to assess potential for a new international supplier sourcing company that would operate between the growing market of Chinese quality suppliers and the western sales- and manufacturing companies.

The objectives of this research project were to examine what factors have an influence (driving forces) on using international sourcing, to develop a business model derived from these factors to seize the IS opportunity, and to find out what are the critical foreign supplier characteristics appreciated by internationalizing SME's. In order to achieve these objectives several areas of relevant literature were reviewed, and the prevailing attitudes and experiences of the Finnish small and medium sized companies towards foreign suppliers and trade intermediaries were examined by conducting a questionnaire survey.

As the research progressed and evolved, the literature review section took the form consisting of the academic fields of SME's internationalization, international sourcing, social capital, business opportunities, business models, and Chinese business environment. Theoretically, this study has appointed attention towards using IS as a feasible solution for the SME's that are today facing the challenges of global competition and multi-national companies' low cost country sourcing. This point of view of internationalizing SME's with limited resources being somewhat neglected within previous research in the field of IS this study has offered deeper insight into the subject.

More importantly, this research has offered empirically important further research on the prevailing attitudes and experiences of the Finnish SME's towards various aspects of IS. It can be concluded that in the SME's experience, international sourcing poses both a set of attractive benefits as well as a broad array of challenges to deal with: The search for lower purchasing costs, access to new suppliers, increased quality and quantity of products and access to lower labor cost are traditionally among the most critical factors for international

sourcing. Although *low price* is the number one key driver for getting into international sourcing activities, it is a secondary factor in comparison to *punctuality, reliability (trustworthiness), and high quality of products*. Suitable quality, punctuality or adequate technical design capabilities are the most critical factors to consider in IS process in order to ensure sustainable IS activity. Furthermore, when it comes into dealing with IS risks the Finns perceive it troublesome to manage *cultural differences and communication* with foreign suppliers, especially with the Chinese, and these factors can heavily hinder IS operations. Also, the subject firms seem to understand that it is important to get to know the Chinese, i.e. to accumulate *social capital and trust*, before doing business. Thus the use of IS intermediaries was perceived very beneficial as the SME's do not have the resources, time or skills to perform activities related to this process. *The IS intermediary's competitive advantage is their knowledge of the Chinese and their presence at the Chinese market.*

It can be argued that this research has been successful as the main findings of this study provided further knowledge on the objectives set in the beginning of the study process. Clear evidence has been found that seems to show that there are untapped *IS opportunities* within the IS market. These opportunities thrive from the *driving forces of the IS*, which include globalization and global competition, SME's lack of resources for internationalization, as well as the emergence of IS and the trend of IS becoming more and more common. It has become apparent that by successfully sourcing the Chinese quality suppliers the IS company and the IS entrepreneur can indeed offer significant added value for the western SME's with limited resources. In the modern global economy offshore sourcing is no longer only the strategy for a few advanced organizations but it is the common contribution to any company's competitiveness and survival. Clearly, companies with insufficient resources rarely submit themselves into an internationalization process. Thus, this study suggests that even the smallest of SME's or companies with most limited resources can actively seek and benefit from internationalization and offshore sourcing with the help of competent IS intermediaries.

Also, from the important practical standpoint, the various elements discovered in the process of research were adapted into a cohesive *international sourcing business model*, as called for by the research's objectives. The components of this business model included the strategic choices, the value network, and the value creation. Value capturing,

i.e. cost, financial aspect, and profit calculations were not included due to limitations with the scope of this study. The business model draws its depth from the analysis of IS, which includes the structure of an IS value network, the driving forces of IS, an extensive coverage on the critical functions, obligatory features and processes for the IS company and the IS entrepreneur, as well as a description and reasoning of the IS opportunities. From an entrepreneurial perspective, this business model offers a strong tool for international sourcing endeavoring and for IS opportunity development. From an academic perspective, the business model encloses a new way of portraying factors critical to the research of IS as an academic field: It sheds some light on the more novel approach of IS as the means for SME's to actively seek internationalization and offshore sourcing.

Like most studies, this work has its limitations: The limitations of this research arise most notably from its nature of a mainly qualitative study with limited quantitative data that has utilized case-companies which are more or less experienced in international sourcing. Due to this fact it should be carefully considered whether or not these results are applicable for generalizing. Also, as this thesis is of the qualitative and explorative nature, increasing the number of survey respondents would have considerably increased the significance of this study's quantitative results' applicability and dependability. On the other hand, also the strength of this study rises from only examining companies that are already experienced in the field of IS. Due to this research setting this thesis has been 1) able to unravel critical factors related to IS with real-life examples of successful SME's that have used IS and IS intermediaries as a means of internationalization, and 2) able to attain comparable results to the similar Italian study conducted by Nassimbeni and Sartor in 2005.

However, there is an apparent need for more detailed future research that arises from this setting. The approach of IS as the means for SME's to actively seek internationalization and offshore sourcing is rather modestly researched. Therefore, more detailed and preferably international research is called for on the topic of international sourcing's capability of aiding western SME's in internationalization, in offshore sourcing, in value adding, and in improving their competitive capabilities. In addition, it would be rather interesting to perform similar research on experiences of SME's that have only very lately started offshore sourcing in China, and especially exclusively through an IS intermediary. Naturally, the search for researchable companies that fulfill these features could prove to be somewhat troublesome.

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## 8. Appendix

### 8.1 Research Questionnaire

**Helsinki School of Economics**

Master's degree thesis study

Tuomas Pättö

**Research Questionnaire**

3.6.2009

#### **International sourcing and procurement with foreign suppliers**

The purpose of this questionnaire is to research the attitudes and expectations of Finnish small- and medium sized companies towards foreign suppliers as well as trade agents in international business (importing and procurement).

Answer based on your individual expectations and/or experiences.

Completion of this questionnaire will take approximately five minutes.

***All information in this questionnaire will remain anonymous and confidential.  
Results may be used in an HSE thesis and will not in any way provide any individual information or data.***



These questions are meant to track your experiences and expectations on ***international trade agents and other such trade intermediaries***. Please answer accordingly with short explanations.

1. Have you used intermediaries or agents in your import/procurement activities? What were your experiences, positive or negative?
2. Why do you use intermediaries or why do you not?
3. What characteristics would you expect from your international trade intermediary?

The remainders of the questions are meant to track your experiences and expectations on **foreign suppliers**. Please answer accordingly by ticking the answer boxes. Questions should be answered on the scale of 1 to 5. (1 = not important at all, 5 = extremely important)

4. Please specify how important the following factors are in relation to **problems with business negotiations with foreign suppliers**.

|   | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Size of negotiation team/number of participants |   |   |   |   |   |
| Time limitations                                |   |   |   |   |   |
| Cultural differences                            |   |   |   |   |   |
| Limited authority of the negotiator             |   |   |   |   |   |
| Communication & language                        |   |   |   |   |   |
| Differences in conflict handling habits         |   |   |   |   |   |
| Differences in individual behavior              |   |   |   |   |   |
| Geographical separation                         |   |   |   |   |   |
| Dishonesty of the international supplier        |   |   |   |   |   |

Specify any others not mentioned above:

|  |  |  |  |  |  |
|--|--|--|--|--|--|
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5. Please specify how important the following factors are in relation to **making decision to start a new international business operation**.

|  | 1 | 2 | 3 | 4 | 5 |
|--|---|---|---|---|---|
| More advantageous taxation                     |   |   |   |   |   |
| Global competition                             |   |   |   |   |   |
| Reduction of trade barriers                    |   |   |   |   |   |
| Access to resources not available domestically |   |   |   |   |   |
| Developing a presence in a foreign market      |   |   |   |   |   |
| Access to more advanced technologies           |   |   |   |   |   |
| Possibility of getting less expensive labor    |   |   |   |   |   |
| Purchasing less expensive materials and goods  |   |   |   |   |   |

Specify any others not mentioned above:

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Questions should be answered with scale of 1 to 5. (1 = not important at all, 5 = extremely important)

6. Please specify how important the following factors are in relation to **selecting foreign suppliers**.

|   | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Price                                   |   |   |   |   |   |
| Suitable quality                        |   |   |   |   |   |
| Broad product range                     |   |   |   |   |   |
| Ability to meet required specifications |   |   |   |   |   |
| Punctuality of delivery                 |   |   |   |   |   |
| Design capability                       |   |   |   |   |   |
| Terms of payment                        |   |   |   |   |   |
| Exclusive commitment                    |   |   |   |   |   |
| Geographical proximity                  |   |   |   |   |   |
| Proper technological capabilities       |   |   |   |   |   |
| Flexibility with volumes                |   |   |   |   |   |
| Economic-Financial reliability          |   |   |   |   |   |
| Technical assistance after sales        |   |   |   |   |   |
| Manufacturing specialization            |   |   |   |   |   |

Specify any others not mentioned above:

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7. Please specify how important the following factors are in relation to **worst problems that may rise with foreign suppliers**.

|   | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| Lack of direct communication                        |   |   |   |   |   |
| Difficulties with supplier evaluation               |   |   |   |   |   |
| Difficulties with unreliable supplier relationships |   |   |   |   |   |
| Difficulties in managing logistics                  |   |   |   |   |   |
| Cultural and language difficulties                  |   |   |   |   |   |
| Exchange rate instability                           |   |   |   |   |   |
| Political instability of foreign countries          |   |   |   |   |   |
| Customs barriers                                    |   |   |   |   |   |

Specify any others not mentioned above:

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