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SUPPLY CHAIN ADAPTATION OF FINNISH COMPANIES IN CHINESE INSTITUTIONAL ENVIRONMENT

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Table of Contents

1	INTRODUCTION	8
2	LITERATURE REVIEW	11
2.1	Contingency Theory	11
2.2	Institutions	13
2.3	Resources	18
2.4	Capabilities.....	21
2.5	Adaption	28
2.6	Theoretical Model	38
3	CHINESE INSTITUTIONAL ENVIRONMENT.....	41
3.1	History of China	41
3.2	Confucianism	43
3.3	Guanxi	44
3.4	Guanxi as a Competitive Advantage.....	49
3.5	Chinese Business Environment.....	51
4	METHODOLOGY	54
4.1	Case Selection	54
4.2	Instrument Development	56
4.3	Data Collection.....	56
4.4	Data Analysis	57
4.5	Reliability and Validity	57
5	ANALYSIS AND RESULTS	60
5.1	Institutional Environment.....	60
5.1.1	Political and Social System.....	61
5.1.2	Capital and Financial Markets	65
5.1.3	Openness	66
5.1.4	Product Markets	66
5.1.5	Labor Markets	68
5.2	Resources	70
5.2.1	Financial Resources	70
5.2.2	Physical Resources.....	70
5.2.3	Human Resources	71

5.2.4	Technological Resources	74
5.2.5	Reputation	75
5.2.6	Organizational Resources	76
5.3	Capabilities.....	77
5.3.1	Cost	77
5.3.2	Quality	78
5.3.3	Flexibility.....	79
5.3.4	Innovation	80
5.3.5	Service	81
5.3.6	Delivery	82
5.3.7	Relationships.....	83
5.4	Small Companies Supply Chain Adaptation.....	85
5.5	Large Companies Supply Chain Adaptation.....	89
5.6	The Most Important Institutional Factors	90
5.7	The Effects of Institutions on Resources and Capabilities.....	91
5.8	Critical Resources and Capabilities	99
5.9	Adaptation of Supply Chains of Finnish Companies in China	100
6	DISCUSSION.....	102
6.1	Social System.....	102
6.1.1	Harmony	102
6.1.2	Hierarchy	103
6.1.3	Building of Moral Potential	104
6.1.4	Kinship.....	105
6.1.5	The Pursuit of Good Life and Good Career.....	106
6.2	Fast-Paced Business Environment	109
6.3	Labor Markets	111
6.4	Adaptation	112
7	CONCLUSIONS	115
7.1	Managerial Implications.....	117
7.2	Research Limitations.....	117
8	REFERENCES	119
9	APPENDICES	129

List of figures

Figure 1 Institutions (Khanna, Palepu, Sinha 2005, 9-14).....	14
Figure 2 Resources (Grant, 1991, 119)	20
Figure 3 Capabilities	22
Figure 4 Progression of Dyadic Adaptation (Canning & Hanmer-Lloyd, 2002, 623-628) 30	
Figure 5 Power and The Drivers of Adaptation, Adapted (Knoppen & Christiaanse, 2007, 222).....	32
Figure 6 Adaptation in High Complexity Environment, adapted from (Gröbler, Grübner, Milling 2006, 258, 272-273)	34
Figure 7 Adaptation in Low Complexity Environment, adapted from (Gröbler, Grübner, Milling 2006, 272-274)	35
Figure 8 Supply Chain Dynamic and Structural Flexibility (Christopher & Holweg 2011, 70).....	36
Figure 9 Drivers of Adaptation	38
Figure 10 Theoretical Model.....	39
Figure 11 Circles of Guanxi, adapted from (Chen & Chen, 2004, 312)	47
Figure 12 Chinese Culture on Resources and Capabilities	92
Figure 13 Logic model explanations.....	93
Figure 14 Effects of Chinese Culture on Supply Chain Management	93
Figure 15 Fast-Paced Business Environment and Resources and Capabilities.....	95
Figure 16 Effects of Fast-Paced Business Environment on Supply Chain Management	96
Figure 17 Connections between Labor Force and Resources and Capabilities	97
Figure 18 Effects of Labor Force on Supply Chain Management	98
Figure 19 Adaptation of Supply Chains of Finnish Companies	101

Figure 20 Effects of Confucian Thought on Doing Business in China	109
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List of tables

Table 1 Capabilities Typology	26
Table 2 Typology of Drivers of Adaptation.....	37
Table 3 Stages of Building Guanxi (Chen & Chen, 2004, 310)	45

List of Abbreviations

3PL	Third party logistics
CAS	Complex adaptive system
ERP	Enterprise Resource Planning
GDP	Gross domestic production
MNC	Multinational Corporation
OECD	Organization for Economic Cooperation and Development
OM	Operations management
RMB	Ren Min Bi, the currency of China
SC	Supply Chain
SME	Small and medium sized enterprise
SOP	Standard Operating Procedure
TQM	Total quality management
VAT	Value Added Tax

1 INTRODUCTION

In the last three decades the field of supply chain management (SCM) has seen the rising of so called best practices; methods that when implemented will considerably enhance supply chain performance. Such concepts include Total Quality Management (TQM) and Lean Production. These practices have been seen as universal in the sense that they are applicable to any supply chain or organization, although in reality this might not be the case as for example Lean Manufacturing is not necessarily the right choice for all companies. (Sousa & Voss 2008, 698.) Despite supply chains becoming more efficient and cost-effective, they still haven't been able to reap competitive advantage over their competitors (Lee, 2004, 2). Thus there has been a shift from universal best practices towards understanding the context and the conditions under which each practice is most effective, a striving towards finding the best strategic fit in the business realm a company or a supply chain is operating in (Sousa & Voss, 2008, 711). This leads us to contingency theory, which states that in order for organizations to operate the best possible way, they must align their internal capabilities with their external conditions (Meznar & Johnson, 2005, 120).

There can, however, still be some common features that the most successful supply chains share. According to Lee the most successful supply chains share three distinct qualities; agility, adaptability and alignment. Agility refers to a supply chains ability to respond to short-term market changes quickly, adaptability refers to supply chains ability to adjust its design over time to accommodate market changes and alignment refers to the ability to improve the performance of the entire supply chain through common incentives. (Lee, 2004) It has been proven that supply chains are complex adaptive systems that evolve over time (Wycisk, McKelvey, Hulsmann, 2008, 11). This paper will focus on supply chain adaptation, especially from the perspective of Finnish companies operating in China.

Peoples Republic of China, which after this will be referred to as China, is the world's second largest economy, has the largest population and is geographically the fourth largest country in the world. In 2013 it surpassed the United States as the largest trading nation in the world (Finpro, 2014). Since the market liberalization reforms that started in 1978, China has seen tremendous economic growth. Since 1978 the average annual growth rate of GDP has been about 10 percent, the fastest in the world (World Bank). Average household incomes have been increasing both on the countryside and in urban areas on average 7 percent annually over the last three decades and as a result poverty has decreased dramatically, although heavy regional differences exist. The major cities on the coast of China are by far the most developed, the large cities inland come right after and towards inland the country is poor and underdeveloped (Lin, Zhuang, Tang, Lin, 2008, 1.) Thus it is no wonder that many western companies are interested in entering China to

take advantage of China's cheap labor force and to establish themselves in the world's largest potential market (Jiang, 2002, 184).

Despite surviving the global financial crisis better than practically any other OECD country and continuing the fourth decade of rapid growth (OECD, 2013, 13) the Chinese economy is not easy to operate in. Even though the Chinese economy as a whole is the second largest in the world (United Nations, 2012), it ranks as the 96th out of 189 countries in ease of doing business (Doing Business 2014, 5). On the Logistic Performance Index the score is relatively better, scoring 27th out of 166 countries, which for upper middle income country is very good (LPI, 2014, 9). Strong competition, cultural differences, establishing profitable service business, availability of educated Chinese workers and managers as well as differing goals amongst collaborating partners have all been identified as difficulties Western companies face when entering China (Gebauer, 2007, 2). Although the Chinese business culture is changing more towards that of the West, Western managers still need to know the customs and the culture of the Chinese when operating in China. Trust, personal relationships or *guanxi* (关系) are essential in building a successful business relationship in China. (Chua, 2012, 33.)

For the Finnish economy, China is a significant player. In 2012 China was Finland's fourth largest trading partner. The total amount of trade with China was over €7 billion of which €2.6 billion was exports and €4.6 was imports. There are over 300 Finnish companies operating in China, that altogether have invested at least €10 billion and currently employ some 60 000 people. (Finnish Chinese embassy, 2012.) It is therefore clear that China is significant both for the global economy as well as for Finnish companies. Therefore it is of vital interest that the Finnish companies understand the Chinese business environment and adapt their operations in accordance with the local environment. China is in rapid transformation and even established companies need to be able to adapt to their business environment in order to flourish.

This thesis will establish that the so called best practices that have been identified in supply chain management do not necessarily work in their original form for all companies (contingency theory) and that supply chains are and need to be adaptive in order to succeed in complex environment. In terms of environmental contingencies, this thesis will focus on institutions, as they structure human interactions in political, social, and economic aspects of life (North, 1991, 97) and have been shown to be the most significant determinant of a country's income (Rodrik, Subramanian, Trebbi 2004, 135). Subsequently creating the appropriate response to the institutional environment will often determine the success or failure of a company (Henisz & Swaminathan 2008, 539).

Thus this thesis will try to identify the main institutions affecting Finnish companies doing business in China and establish the methods of adaptation Finnish companies engage in to form a better strategic fit with the surrounding business environment. The research questions of this thesis are:

- What are the main institutions affecting Finnish companies supply chain management in China?
- How do Finnish companies adapt their supply chains to form a better strategic fit with the Chinese institutional environment?

This thesis is limited to observing Finnish companies' supply chains, and how they adapt in China to form a better fit with the Chinese business environment, subsequently expanding the focus on how to form the best possible supply chains in the Chinese business environment. Since China is a rapidly growing market that presents many new opportunities for business growth it should automatically be seen as an area of interest. Although there is some research done on China, the business environment is still very much foreign to most Westerners. A secondary goal of this thesis is to make the Chinese business environment more easily understandable to business practitioners, especially from the perspective of Finnish companies.

This thesis will begin by presenting a review of existing literature, in which key concepts such as resources, capabilities, institutions and adaptation are presented. The literature review also contains a theoretical model regarding the adaptation of supply chains, which was created specifically for this thesis. The literature review is followed by a chapter regarding the Chinese institutional environment. The reason for including a separate chapter about this topic is that the Chinese institutional environment differs vastly from that of Western countries, and thus was seen as appropriate to be presented it in a separate chapter. This chapter presents the key concepts of Confucianism and Guanxi, which in particular affect the Chinese institutional environment. This is followed by a methodology chapter in which the decision and methods of conducting this thesis are presented.

Analysis and results chapter contains the presentation and analysis of research data that was collected for this thesis. In addition to dwelling on the key concepts of institutions, resources, capabilities and adaptation from the perspective of Finnish companies doing business in China, this chapter establishes the most important institutional factors that affect the supply chains of Finnish companies in China and the methods of adaptations that the companies interviewed engage in.

This chapter is then followed by discussion, in which the analysis and results is mirrored with the literature review, especially regarding Confucianism and Guanxi to form a better understanding of supply chain management of Finnish companies in China. This chapter is followed by conclusions.

能因敵變化而取勝，謂之神

He, who can modify his tactics in relation to his opponent and thereby succeed in winning, may be called a heaven-born captain (Sun Tzu, The Art of War).

2 LITERATURE REVIEW

The following chapter presents the literature regarding the topics of this thesis. Firstly the chapter presents contingency theory, which states that in order for supply chains to succeed, they must form a fit with the internal capabilities and the external context. To conceptualize the external contextual factors, this thesis focuses on institutions, which are presented after contingency theory in this chapter. Internal capabilities are conceptualized by capabilities, which in turn are built upon resources, both of which are presented in this chapter. As supply chains are trying to find the perfect fit, they must adapt their resources and capabilities. Adaptation is also dwelt into in this chapter. Finally this chapter culminates in the establishment of a theoretical model, which combines resources, capabilities, institutions and adaptation into a theoretical model depicting how supply chains are finding a fit between the institutional environment and resources and capabilities.

As this thesis dwells on the issues of supply chain adaptation, it is worthwhile defining all the major terms used in this thesis for the sake of clarity. Supply chain management is defined, according to the Council of Supply Chain Management Professionals as follows: “Supply chain management encompasses the planning and management of all activities involved in sourcing and procurement, conversion, and all logistics management activities. Importantly, it also includes coordination and collaboration with channel partners, which can be suppliers, intermediaries, third party service providers, and customers. In essence, supply chain management integrates supply and demand management within and across companies.” (CSCMP, 2014.) Supply Chain is defined as “The supply chain (SC) encompasses all activities associated with the flow and transportation of goods from the raw material stage (extraction) through to the end user, as well as associated information flows. Materials and information flow both up and down the supply chain.” (Handfield & Nichols, 1999, 2.) “According to Merriam Webster dictionary (2015), adaptation is: “the process of changing to fit some purpose or situation: the process of adapting.”

2.1 Contingency Theory

The theoretical background for this thesis will start from contingency theory, establishing that the success of a company is not only dependent on its utilization of the so called best practices, but also from the external context of its business environment. (Sousa & Voss, 2008, 698.) Contingency theory in its essence states that there is no best way to organize a company and that the most optimal solutions for organizing structures and processes of a company depend on both internal capabilities of a company as well as on the external factors outside the company. Thus business performance depends (is contingent) on a variety of factors. Companies must adjust their strategy and structure to

create a better fit with internal capabilities with external conditions. (Meznar & Johnson, 2005, 120.) This notion establishes that it is important to look at a company and the supply chain, as well as the business environment they are operating in, in order to understand the success and failure factors. Contingency theory research has shown that the most essential factors for success are the correct combination of strategy, organizational structure and environment. (Heiens & Pleshko, 2011, 32-34.) Contingency theory is also useful, helpful and appropriate when examining business-government relations (Meznar & Johnson, 2005, 137). When applying contingency theory to technology however, one needs to exercise caution because technology and organizational structure may behave differently in contingency theoretical context (Ketokivi, 2006, 226).

Contingency factors lead to companies creating a strategy that best suits the surrounding business environment they operate in, thus achieving a strategic fit between firm's internal capabilities and external contingencies. How good this strategic fit is determines the amount of competitive advantage and thus success (Ju, Chen, Li, Lee, 2005, 640-641).

As contingency theory states, companies and their supply chains are affected by their surrounding business environment into which they need to adapt to. Supply chains have been shown to be adaptive and even to work as complex adaptive systems (CAS) (Wycisk, McKelvey, Hulsmann, 2008, 118). Generally they can be defined as "systems that emerge over time into a coherent form, and adapts and organizes itself without any singular entity deliberately managing or controlling it" (Holland, 1995). In supply chain context they can be defined as emerging, self-organizing, dynamic and evolving (Choi, Dooley, Rungtusanatham, 2001, 364). This means that new structures, patterns properties and processes emerge from within the system through the process of self-organization without being imposed by external actors upon the system in a dynamic and changing environment that evolves over time, as does the system itself. Thus in supply chain management context adaptability can be defined as: "evolving over time as economic progress, political shifts, demographic trends, and technological advances reshape markets" (Lee, 2004, 1).

We need to make a clear distinction from the ability of the supply chain to react to long term changes and the ability to react to short term changes. By separating supply chain adaptability from supply chain agility, for which one definition is: "the capability of the firm, both internally and in conjunction with its key suppliers and customers, to adapt or respond in a speedy manner to marketplace changes as well as to potential and actual disruptions, contributing to the agility of the extended supply chain." (Braunscheidel & Suresh, 2009, 119.) Lee defines supply chain agility as the ability to respond quickly to sudden changes in supply or demand, handle unexpected changes smoothly and cost-effectively and thus being able to recover promptly from shocks such as natural disasters, epidemics and computer viruses (2004, 1). In conclusion, supply chain agility

refers to supply chains ability to react to short term disruptions, and as an end result remain largely the same, whereas supply chain adaptability refers to supply chains ability to adapt itself over longer periods of time to be able to cope with the surrounding environment in a more effective way.

To start applying contingency theory, we need to first identify important contingency variables that distinguish between contexts, then group different contingencies based on these variables and lastly determine the most effective internal structure and design or identify responses in each major group. (Sousa & Voss, 2008, 698.)

2.2 Institutions

In order to identify environmental factors affecting supply chains in foreign countries, or contingencies as contingency theory states, this thesis will focus on institutions. Institutions structure human interactions in political, social, and economic aspects of life. They exist in order to reduce transaction costs as well as production costs in order to increase benefits of trade (North, 1991, 97). Making appropriate choices and responses to changes to the institutional environment takes a considerable amount of time and effort from managers, which also means that appropriate actions taken in regard to institutions often dictates the success or failure of a company. (Henisz & Swaminathan 2008, 539.) The reason why this thesis concentrates on institutions to depict the external business environment is that institutions are shown to be the main determinant of a country's income, trumping other variables, such as geography and trade (Rodrik, Subramanian, Trebbi 2004, 135).

Institutions can be classified into formal and informal institutions. Formal institutions include laws, regulations and property rights. (North, 1991, 97.) Formal institutions are openly codified so that they are known about through the official channels through which they are also established. (Estrin & Prevezer 2011, 44.) Informal institutions on the other hand include behavioral norms, customs, traditions, sanctions and taboos (North, 1991, 97-98) created and enforced outside the common official channels (Estrin & Prevezer 2011, 44). Corruption often occurs in situations where formal institutions lack necessary power to act and informal institutions need to substitute them. The stronger the formal institutions, the less corruption generally occur. (Zhan, 2012, 106.) Khanna, Palepu and Sinha (2005) have classified institutions into five categories, each including formal and informal institutions that companies can use in order to map out the institutional framework of a target market. The idea is to spot the relevant institutions and especially the lack of properly functioning institutions, also referred to as the institutional void. This regularly occurs in developing countries and extensive means need to be taken in order to consider all the facets of the institutional environment in a developing country. The

five categories that institutions are classified into are political and social system, openness, product markets, labor markets, and finally capital markets. (Khanna, Palepu, Sinha 2005, 9-14.)

To represent institutions, Figure 1 shown below was created to more easily illustrate the main categories of institutions.

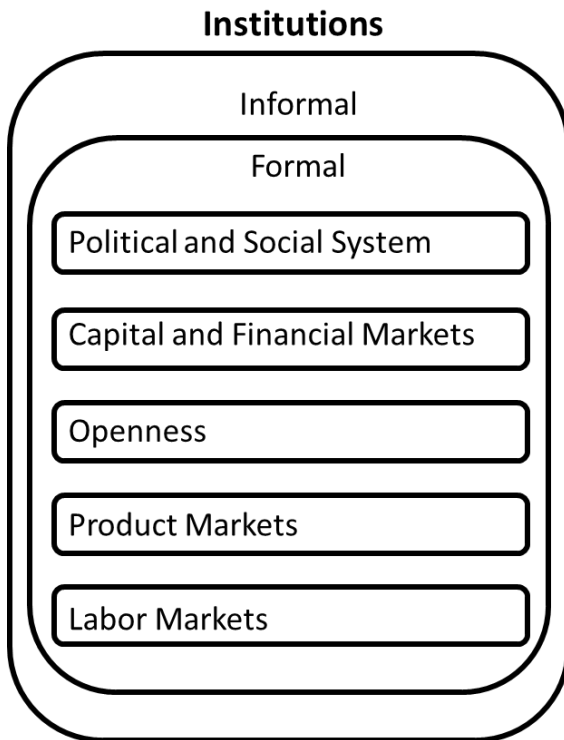


Figure 1 Institutions (Khanna, Palepu, Sinha 2005, 9-14)

Figure 1 identifies the main institutions according to Khanna, Palepu and Sinha (2005), both formal and informal. This framework is used to identify the most important environmental contingencies a supply chain faces when entering new markets and is used to identify the most important contingencies affecting Finnish companies and their supply chains when operating in China. The contingency factors that affect supply chains, as per contingency theory states will hereafter be referred to as institutional factors.

The political and social system affects supply chains in a multitude of ways, including through product, capital and labor markets. Social system affects supply chains through relationships between linguistic, ethnic or regional groups and through interactions and mutual relationships of those groups. Identifying these groups, their comparative size and influence in politics and in economy is important. (Khanna, Palepu, Sinha 2005, 7-10.) Identifying the underlying effects of social systems are also important, because religion for example may affect entrepreneurial attitudes of a group, as well as the formal institutions that support entrepreneurship, directly having an effect on the number of SMEs per capita (Kshetri, 2010, 358).

It is also important to find out how the country's political system works, if there are elections and if there is a separation of powers between branches of government. In political systems one needs to identify whether or not the political power is decentralized, in which case the most influential players at each level need to be identified. In case where political power is centralized, one needs to find the center of power and bureaucracy. Regardless of the way political power is divided, companies need to find out if there are checks and balances for the governmental functions, is there oversight over the political functions and if the political players operate independently or together. Apart from the functions of government, company's main concern should be the extent to which the target market and its political system respect private property, intellectual property rights, contracts etc. and how these are enforced. Also worth mentioning is that companies need to find out how much the government in the target market has gone beyond regulating companies to actually interfering with the management of the company. Other related topics concerning the political and social system of the target market are the significance of the press and what is the state of civil society in that target market. Gaining good knowledge over the social and political situation and workings of a country is important, together with gaining local trust throughout the society. (Khanna, Palepu, Sinha 2005, 7-10.)

Openness of a market is a challenging task to evaluate and many things need to be taken into consideration. Openness may refer to the political and social attitudes towards foreigners investing in that particular market, in which political and social systems play a role. Indicators of this can include restrictions on foreign direct investments and whether or not they are there to protect domestic companies or even domestic monopolies. Additional restrictions can include restricting foreign intermediaries to engage in market research, advertising, the media, auditing, consulting etc. Generally openness can be represented by the ease at which global intermediaries are allowed to operate in that particular market. (Khanna, Palepu, Sinha 2005, 7, 10.) Well-functioning political and social institutions have been shown to increase country's openness (Rodrik, Subramanian, Trebbi 2004, 135). When it comes to setting up business, it is worthwhile asking where companies are allowed to be located, what are the effects of barriers of trade on their business and if the country has signed any free trade agreements. Openness may also refer to the attitudes of locals towards accepting new ideas, products and ways of thinking. Another aspect that has to be considered though is that openness can also play as a competitive advantage for a company, due to the fact that in case a company is able to penetrate a relatively closed market, it has a significant advantage over newcomers. (Khanna, Palepu, Sinha 2005, 7, 10.)

Market characteristics are a factor that define the environment where a company operates in, which in turn has an effect on the supply chain structure. Supply chain structure refers to the different parties taking place in the supply chain, in which shape they are

organized in the supply chain, how the different flows in the network are organized, how different players coordinate their actions together and how their incentives are aligned. Market characteristics are connected with horizontal and vertical integration of supply chain members. (Srai & Gregory, 2008, 393.) When analyzing supply chains, analyzing different types of connections (i.e. materials flow versus information flow) will produce different kinds of connective networks. The most critical connections include contracts and several different types of flows. (Hearnshaw & Wilson, 2013, 444.) In short, flows are movement happening within the structures, be it of tangible objects or information (Srai & Gregory, 2008, 393). The right approach to the supply chain structure, especially in the case of choosing suppliers and managing them is especially important in emerging markets (Moser, Kern, Wohlfarth, Hartmann, 2011, 796).

Product markets, both upstream and downstream from a focal company, at developing economies are often in their infancy stage, which is reflected on the advertising and marketing in the target market, as well as in market research. Databases that allow companies to segment their customers or evaluate their credit history are often lacking, which makes acquiring reliable information challenging. A good indicator of this is whether or not international market research companies are permitted to operate in the target market. When it comes to government bodies or advocacy groups evaluating the quality and features of products, they are often non-existent, which can hinder consumer trust in companies providing them with products and services. Again, existence of organizations and publications that independently evaluate consumer products are one indicator of functioning product markets. When it comes to managing supplier relations, companies need to find out the level of supplier market maturity and the possibility of evaluating quality reliably. The existence of companies that can accurately evaluate supplier quality and reliability are an indicator of functioning product markets. This extends to logistics networks and distribution channels that need to be evaluated separately. Consumer perceptions about products, aftersales and defected products need to be also found out, as well as consumer preferences when it comes to trying out new products and foreign products. (Khanna, Palepu, Sinha 2005, 10.)

Labor markets in developing countries have not reached the level of developed countries and thus companies have a hard time recruiting skilled labor and evaluating their capabilities. Education institutions and their level from secondary education through engineering and management training is a key issue. Establishing what the level of an educational institution, with the exception of elite institutions, is a daunting task if proper evaluation methods are not in place or in case there are no guarantees the overall level of education is adequate. Another issue, when it comes to labor markets that needs to be evaluated, is the culture of work. What are the employee turnover rates, how is this perceived, is seniority valued over performance, and how are post-recruitment training opportunities taken care of? Working culture needs to be evaluated from the perspective of

higher level people as well, for example how easily talented top level managers are retained, does the company have capabilities of enforcing top level contracts or is it powerless if they decide to leave to a competitor and steal company secrets? Cross cultural employment might also cause trouble through legislation and people's perceptions over working abroad or working for a foreign manager. Legislation when it comes to employee rights needs to be examined as well. Are the workers unionized, how easy is it to lay off workers and how do the work related laws work? Recruitment might also be a problem, because where recruitment consulting companies and other intermediaries exist for high level employees, there is often a lack of such services for recruiting middle management and other professionals. (Khanna, Palepu, Sinha 2005, 8, 13.)

Capital and financial markets in developing countries are often not at all comparable to developed countries when it comes to sophistication and the existence of intermediaries that ease acquiring capital and financing. Raising capital is a difficult task due to the lack of merchant banks and venture capital companies. It might also be difficult for companies to use more sophisticated financial instruments. The criteria for investment decisions might be affected by family ties and other noneconomic factors. Getting information regarding credit ratings or creditworthiness of other companies is hard due to the fact that companies providing reliable investment analysis are non-existent. Even getting reliable accounting information might be difficult. Collecting extended credit might often be difficult, not to mention adhering to local legislation and joint venture agreements. (Khanna, Palepu, Sinha 2005, 8, 14.) In more informal business systems often credit and insurance arrangements are provided by non-market institutions instead of banking and insurance companies. Often they require non-anonymous peer reviewed methods of granting credit, which is more than anything else, based on trust. (Millar, Choi, Cheng 2009, 459.) Courts might not co-operate fully when it comes to fraud claims and regulators might be ineffective when it comes to monitoring the financial institutions. Thus it is evident that companies operating in developing economies cannot solely rely on the foreign market to provide them with credit or equity capital to finance their operations in the target market. (Khanna, Palepu, Sinha 2005, 8, 14.)

To conclude, institutions have a major effect on supply chains operating in emerging markets and thus will provide the framework for understanding the business environment in China from the perspective of contextual factors affecting supply chains and their adaptation. The institutional framework is divided into political and social system, capital and financial markets, openness, product markets, and labor markets.

2.3 Resources

As stated by contingency theory, in order for organizations to operate in the best possible way, they must align their internal capabilities with their external conditions (Mezner & Johnson, 2005, 120). Internal capabilities however are built upon resources that organizations or supply chains possess. In addition, supply chains today operate in volatile environments in which customer preferences, as well as the surrounding environment changes very rapidly. In these kinds of environments formulating on a strategy based on serving a specific customer need is often hard and not easily sustained over a period of time. A more stable basis of formulating a strategy is by focusing on resources, which in turn produce capabilities. (Grant 1991, 116.) Thus in order to examine how supply chains adapt their capabilities to surrounding environments, we must also examine supply chain resources that produce supply chain capabilities.

According to Grant (1991) resources can be defined as “inputs into the production process”. Individually resources are only rarely productive, but when combined together with other resources in a cooperative and coordinated way, they become productive. (Grant 1991, 118-119.) Supply chains need to give proper attention to allocating these resources if they wish the resources to enhance the performance of the supply chain in any way (Tracey, Lim, Vonderembse 2005, 186). This process of binding resources together in a meaningful way builds capabilities, which are the cornerstone of competitive advantage (Grant 1991, 118-119). Whether or not a resource is a source for competitive advantage can be evaluated through a set of conditions that need to be met. These conditions are value, rarity, imperfect tradability, and costliness to imitate. Value refers to the resource’s ability to help companies to engage in strategies that will elevate company efficiency or effectiveness. Rarity refers to the uniqueness and relative commonness of a resource. Imperfect tradability refers to the ease at which resources can be transferred from one party to another. This transfer might be hindered due to the immobility of a resource related to company, location, as well as other factors. Costliness to imitate refers to the difficulty, barriers, and cost associated with competitors seeking to imitate a resource. (Fahy 1996, 26-27.)

The sustainability of the competitive advantage given by resources should be evaluated through four characteristics a resource possesses: durability, transparency, transferability, and replicability. Durability refers to the rate at which depreciation happens to a resource and at which point the resource becomes obsolete. This varies dramatically between different types of resources. For example some technologies might become obsolete quite quickly, whereas reputation tends to depreciate at a much slower pace. Transparency refers to the ease at which competing companies can recognize the capabilities as well as the underlying resources required to produce competitive advantage. After rec-

ognizing the necessary resources and capabilities required to produce a competitive advantage, transferability steps into play. Transferability refers to the ability of competitors to transfer the competitive advantage to themselves either in the same market or in some other market through means of purchasing or some other method of acquirement. Competitive advantage might be geographically immobile in a sense that it cannot be transferred from one location to another, specific capabilities required to produce the specific competitive advantage might not be transferable to another company, and resources such as reputation might be hard to transfer without a significant losses. Finally replicability refers to a situation where acquiring the competitive edge might not be possible, in which case imitating the resources and capabilities is the only chance of achieving the competitive advantage. Replicability refers to the possibility of competitors to replicate the resources that are required to produce capabilities that in turn lead to competitive advantage. In general, tangible resources are the easiest to replicate, whereas organizational resources such as organizational routines and organizational culture are the most difficult to replicate. (Grant 1991, 124-127.)

In addition to supply chain resources being strategic in nature, they also need to be consistent with the overall strategy of the organizations involved in order to produce most value for the supply chain when pursuing strategic goals. This helps in aligning the strategic resources of the supply chain with the overall objectives of the entire supply chain. As a result, supply chains can either adjust their strategy, adjust their resources, or do a combination of both. (Rangone 1999, 240-241.) Resources vary in importance from organization to organization and from industry to industry (Markides & Williamson 1996, 363). Thus it is evident that resources are not stable over time, but can be affected by managerial decisions. These decisions can be divided into four groups: redirecting existing resources, adding new resources to the company repertoire, discarding resources, or a combination of the above. Managerial decision are also a key to configuring supply chain resources in a way that uses them most effectively to create competitive edge. (Hansen, Perry, Reese 2004, 1281.)

SMEs often have limited resources, which they often employ in an inefficient manner. Most efficient SMEs are found to concentrate on cost reduction and tend to spend less money on advertisement and marketing than other SMEs. Budget allocation and tight control on marketing efforts should thus be the main focuses on SMEs in order to produce the best results with their limited resources. (Heilbrunn, Rozenes, Vitner 2011, 238-239.)

Resources can be divided and classified into six categories, which are financial resources, physical resources, human resources, technological resources, reputation, and organizational resources (Grant 1991, 119). The first two resource types are tangible resources, including financial assets a company has, as well as the plants, machines, raw materials (Russo & Fouts 1997, 537) as well as the physical location of the focal companies (Barney 1991, 101). The next three resource types, human resources, technological

resources and reputation are intangible resources. Human resources also includes culture, training, expertise, commitment, loyalty (Russo & Fouts 1997, 537) intelligence and judgment of the individual employees (Barney 1991, 101). Technological resources are divided into two groups: tacit and explicit. The latter can be codified into patents, blueprints, designs and drawings, while the former cannot be codified at all. Thus tacit information exists in the brains of employees. (Tsang 1997, 154.)

Since the resources mentioned above are not productive on their own, an additional resource type needs to be included. Organizational resources are the resources that organize, combine, and manage all the other resources of organizations. (Russo & Fouts 1997, 537.) They include the formal reporting structure within and across companies, the informal and formal methods of planning companies engage in, as well the connections and relationships that groups of people have within the organization as well as with outside groups and individuals (Barney 1991, 101). Tangible resources can be imitated much more easily than intangible resources, and thus cannot sustain competitive advantage over a long period of time (Andersen 2012, 105). Tangible resources can be bought from outside, while intangible resources can in general only be created within organizations (Schroeder, Bates, Junttila 2002, 106).

In this thesis the typology of Grant (1991, 119) is used to depict the resources a supply chain has, which is shown in the Figure 2 below.

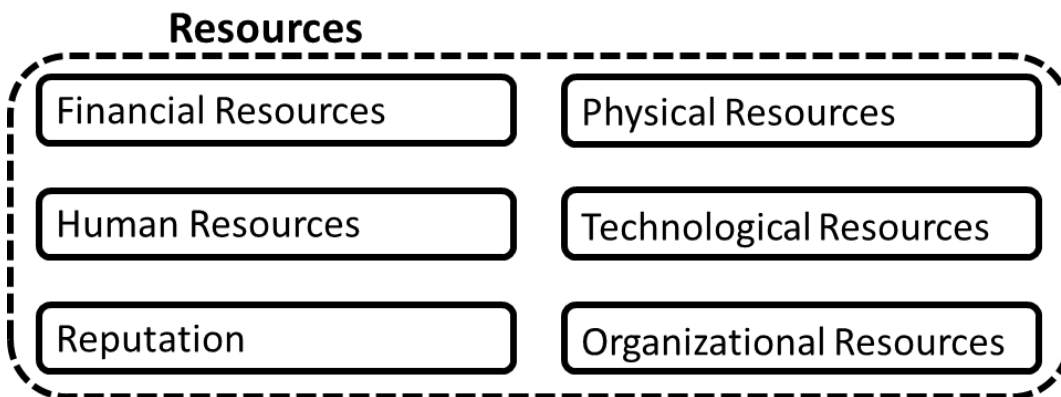


Figure 2 Resources (Grant, 1991, 119)

Other typologies of resources include the division into five different sets of assets, which are customer assets, channel assets, input assets, process assets, and market knowledge assets. The customer assets include brand recognition and customer loyalty. Channel assets include access to an existing channel, loyalty from the distributor side, as well as the stock in the pipeline. Input assets include knowledge concerning imperfect factor markets, loyalty from the side of the suppliers, as well as financial capacity. Process assets include technology and experience regarding products and markets, marketing, as

well as organizational systems to run the processes. Finally market knowledge assets include information regarding the competitors, the markets, and the business cycle. (Markides & Williamson 1996, 348.)

Resources can be seen as inputs to a process that produces capabilities. Tangible resources, except for money, are single-purpose resources in the sense that they are only good as inputs. Money, as well as intangible resources, can be viewed as dual-purpose resources because they work both as inputs, as well as outputs of a process. The accumulation of resources has a positive effect on a supply chain, and thus effort should be put into advancing this accumulation process (Ensign 2004, 129) in order to build and sustain competitive advantage (Bates & Flynn 1995, 239). Resources have to be evaluated in response to their surrounding business environment and the strategic fit they provide. Resources have to be regarded as complex concepts, more than just a quantity and the choice whether to utilize it or not. Resources can, depending on the outside environment, act as a weakness, missed opportunity or even rigidity, in addition to existence as a resource. (Knott 2009, 172.) Resources connect closely to the end product, because most products require a set of several resources in order to be produced, and most resources can be used to produce several different products (Wernerfelt 1984, 171). Resources can also be accumulated through a process of manufacturing innovations, which will over a period of time add to the resources a company possesses (Bates & Flynn 1995, 238).

In international business, supply chains may have to transfer resources across borders in order to do business. Due to the fact that some resources are very much tied to the people working for an organization, transferring resources across borders can be difficult. Small companies most likely have to transfer their resources in a very different manner due to the severe resource limitation they face. (Tsang 1997, 164-165.)

2.4 Capabilities

Capabilities can be defined as something supply chains can do as a result of coordinated use of their resources. These actions are a result of predictable patterns of organizational sequential routines of interactions between resources in an organization. (Grant 1991, 120, 122.) Competences refer to “the major role of strategic management in adapting, integrating and reconfiguring resources, organizational skills and functional competencies to respond to the challenges of the external environment” (Gligor & Holcomb 2012, 445). Supply chain capabilities have been shown to bring companies competitive advantage and critically contribute to company performance (Tracey, Lim, Vonderembse 2005, 186). The path to success lies in developing capabilities that will enhance company

performance, as well as developing appropriate strategies to complement these capabilities so that companies can better respond to the challenging markets. (Tracey, Lim, Vonderembse 2005, 187.)

Capabilities can be classified in many ways. Miller and Roth (1994) for example classified capabilities into 11 groups, whereas Boyer and Lewis (2002) only used three groups to identify the relevant capabilities (Miller & Roth 1994, 289). The generally accepted capabilities are cost, quality, flexibility, and delivery. Innovation and service have also been suggested to be important capabilities. (Boyer & Lewis 2002, 9.) A typology of seven capabilities was created for this thesis and is shown below. In this typology the relevant capabilities are cost, quality, flexibility, innovation, service, delivery, and relationships.

The Figure 3 below depicts the seven capabilities used in building the theoretical framework for this thesis.

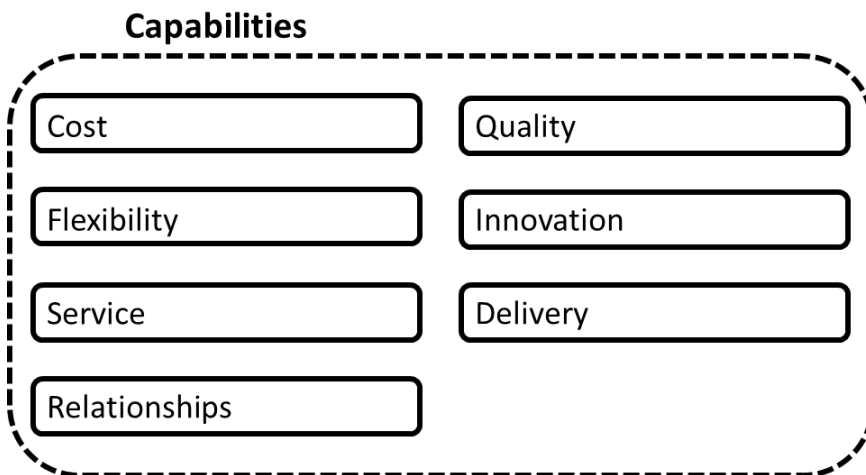


Figure 3 Capabilities

Cost capability refers to the ability of a company to compete on price (Miller & Roth 1994, 289) or to the ability of a company to arrange operations so that they require only few resources as inputs to the process (Swink, Narasimhan, Kim 2005, 432). The most optimal supply chain configuration is such that minimizes the total costs of three components: cost of goods sold, safety stock costs as well as pipeline stock costs (Graves & Willems, 2005, 1178). Cost leadership in itself is a hard position to achieve in the marketplace, due to the fact that only one or two companies at any given time may actually achieve this (Morash 2001, 50-51). This however does not make lowering costs any less significant of a capability. Costs can be lowered for example by reducing inventory through various means, by increasing capacity utilization, reducing production costs by changing the production process, or by increasing labor productivity (Boyer & Lewis 2002, 19). Standardization and simplification of operations also have been found to decrease costs (Morash 2001, 44). The relative importance of low costs compared to other

capabilities however, is not that strong. Individual companies often prioritize other capabilities over costs, even when selecting outsourced services. (Morash & Lynch 2002, 37.)

Quality is evident through many means, including providing high-performance products, offering consistency and reliability, conforming to design specifications better (Boyer & Lewis 2002, 19) delivery date and quantity dependability on a consistent basis, problem avoidance proactively before they arise, avoidance of disruptions in the supply chain in a way that does not adversely affect customers, problem solving, product substitution in case of delay or stock out, as well as the ability to accommodate in situations of product recall. Quality has been noted as the second most important supply chain quality after customer service. (Morash 2001, 42, 44, 54), (Miller & Roth 1994, 289.)

Flexibility is evident, when supply chains are able to make rapid changes to production volumes and to capacity, make changes to design or the product mix, while being able to offer a wide variety of products and product features (Boyer & Lewis 2002, 19) or introduce new products quickly to the markets (Miller & Roth 1994, 289). All of this is done without too significant penalties regarding costs or time involved with executing the changes (Swink, Narasimhan, Kim 2005, 432). There are five types of flexibility supply chains can emit. They are new product flexibility, sourcing flexibility, product flexibility, delivery flexibility, information system flexibility. New product flexibility refers to supply chain's ability to develop new products in a timely and cost-effective manner. In times of shorter product life cycles, the significance of new product development flexibility cannot be understated. Sourcing flexibility refers to supply chain's ability to respond to changes in requirements or volumes of products and components in order to meet customer demand in a timely and cost-effective manner. Sourcing flexibility is analogous to volume flexibility in more traditional manufacturing literature. Sourcing flexibility however covers more topics than volume flexibility, including qualitative aspects of demand management. Product flexibility refers to develop or upgrade existing products according to special needs from customers in a timely and cost-effective manner. This also includes flexibility when it comes to maintaining current product mix. Delivery flexibility refers to the ability distribute and deliver products to customers in a timely and cost-effective manner despite changes. The challenge is in getting the product to the customer as quickly as possible, without large stocks that ruin profits as well as without missing the time-frame for delivery, which ruins reputation. Finally information systems flexibility refers to the ability of supply chain information systems to meet requirements despite changes in the business environment or customer demand. Strong information system flexibility allows supply chains to identify critical information and work with it to adapt to changes that happened in the market place. (Fantazy 2007, 56-67.)

Flexibility has a positive effect on company performance, but not all types of flexibility are as important to all companies. Supply chains in certain industries with demand uncertainty might benefit more from sourcing flexibility for example. (Sanchez & Perez

2005, 696.) Flexibility in itself is not important, because it is the product or service and the availability that the customer is actually paying. Flexibility may however bring added benefits to supply chain performance in the sense of better quality, speed, dependability and cost. (Stevenson & Spring 2009, 965.) Flexibility is extremely hard to measure, which can be considered a testament to its strategic nature (Butler & Ewald 2000, 17).

Innovation capability, sometimes referred to as technological capability or IT capability, is the ability to come up with new products, production or manufacturing processes in order to achieve better technological or managerial performance (Rangone 1999, 235), capability for technological development as well as technological change forecasting, all in order to keep costs down and differentiate the products from those of the competitors. (DeSarbo, Di Benedetto, Song 2007, 107.) This might also cover nation-wide information networks that support advanced manufacturing as well as management technologies (Kim 2006, 1091). The product is in the core of well-functioning supply chain, but designing the best possible product irrespective of its implications on the chain configuration or to the total costs associated with it, do not always provide the highest profits. Simultaneous optimization approach is needed when evaluating the interactions between the product innovation and other competitive capabilities. (Gokhan, Needy, Norman, 2010, 29.)

Service has been attributed as the most important of the supply chain capabilities according to Morash (2001, 42), (Morash & Lynch 2002, 37). Service capability includes responsiveness to customer needs, the ability to provide additional value added services, logistics service differentiation from competitors, customer service and order flexibility according to special needs, order size, volume or composition, customization of products during logistics transits as well as innovative solutions when it comes to specific customers, customer situations or even emergencies (Morash 2001, 43, 54). Service capability also includes the ability to provide customers with after sale service (Miller & Roth 1994, 289). Customer focus has been identified as an important factor contributing to service capability, which in turn has a positive effect on organizational performance (Lado, Paulraj, Chen 2011, 211-212).

The delivery capability of a supply chain is evident in cases where supply chains are able to provide fast deliveries, meet promises they have made about deliveries effectively, when they are able to reduce their lead times (Boyer & Lewis 2002, 19). It is also evident when companies are able to provide distribution to a widespread area, selective coverage to specific customers exclusively, flexibility when it comes to location, for example from a different warehouse, or delivery time flexibility accommodating specific customers, and the ability to provide customers with reverse logistics. Speed is also an issue when it comes to deliveries, the ability to reduce time between order receipt and customer delivery is an important part of delivery capability, as well as the ability to expedite shipments or even partial shipments. (Morash 2001, 43, 54; Miller & Roth 1994, 289).

Relationship capabilities refers to the role, inter-relationships and governance between key networks partners and how roles are divided in the supply chain and how these roles are enforced. This can be achieved through different relationship types, i.e. hard or soft, ownership, coordination and governance within and between companies as well as through means of relative power. This essentially determines the roles and leaders within the supply chain and in what kind of context the interactions between supply chain members are conducted. (Srai & Gregory, 2008, 393.) Relational capability also refers to supply chains ability to effectively and efficiently market, advertise, promote and sell its products (Rangone 1999, 235), (Miller & Roth 1994, 289) as well as sensing what is going on in the market, linking channels and customers together, in addition to monitoring technological change. Relational capabilities also include the ability to segment and target customer groups and price the products effectively, all in order to implement marketing programs in more effective manner. (DeSarbo, Di Benedetto, Song 2007, 107.) Relationship capabilities of product development teams in the supply chain have an effect on the flexibility of product architecture, which is connected to performance of the supply chain. As the skillset of supply chain participants increases, performance goes up as well. In addition when the collaboration capabilities in the supply chain are higher, they have a positive effect on performance. (Ülkü & Schmidt, 2011, 29-30.) Thus the relationship capability is the capability that connects companies with their supply chains, and thus will be of particular importance when examining Finnish companies and their supply chain management in China.

The collection of sources used to establish this typology is shown in Table 1 below with the corresponding capabilities listed by the original authors.

Table 1 Capabilities Typology

Cost Low Logistics Cost (Morash 2001, 42) Productivity (Morash 2001, 42) Cost (Boyer, Lewis 2002, 19) Production Capability (Rangone 1999, 235) Low Price (Miller, Roth 1994, 289) Low-cost Operations (Krajewski, Ritzman, Malhotra 2009, 34) Cost-Efficiency (Swink, Narasimhan, Kim 2005, 432) Low Logistics Cost (Morash, Lynch 2002, 37) Logistics Productivity (Morash, Lynch 2002, 37) Cost Leadership (Kim 2006, 1089) Cost Containment (Butler, Ewald 2000, 12)	Innovation Innovation Capability (Rangone 1999, 235) Technological Capability (DeSarbo, Di Benedetto, Song 2007, 107) IT Capability (DeSarbo, Di Benedetto, Song 2007, 107) Development Speed (Krajewski, Ritzman, Malhotra 2009, 34) Differentiation (Kim 2006, 1089) Technological Capability (Kim 2006, 1089) Design Flexibility (Miller, Roth 1994, 289) Customization (Krajewski, Ritzman, Malhotra 2009, 34) New Product Flexibility (Fantazy 2007, 56)
Quality Quality (Morash 2001, 42) Quality (Boyer, Lewis 2002, 19) Production Capability (Rangone 1999, 235) Conformance (Miller, Roth 1994, 289) Performance (Miller, Roth 1994, 289) Top Quality (Krajewski, Ritzman, Malhotra 2009, 34) Consistent Quality (Krajewski, Ritzman, Malhotra 2009, 34) Quality Assurance (Butler, Ewald 2000, 12)	Service Customer Service (Morash 2001, 42) Information System Support (Morash 2001, 42) After Sale Service (Miller, Roth 1994, 289) Customer Service (Lado, Paulraj, Chen 2011, 205-206) Customer Service (Morash, Lynch 2002, 37) Customer Service (Kim 2006, 1089) Service Delivery (Butler, Ewald 2000, 12)
Flexibility Distribution Flexibility (Morash 2001, 42) Flexibility (Boyer, Lewis 2002, 19) Production Capability (Rangone 1999, 235) Volume Flexibility (Miller, Roth 1994, 289) Broad Line (Miller, Roth 1994, 289) Variety (Krajewski, Ritzman, Malhotra 2009, 34) Volume Flexibility (Krajewski, Ritzman, Malhotra 2009, 34) Sourcing Flexibility (Fantazy 2007, 56) Product Flexibility (Fantazy 2007, 56) Delivery Flexibility (Fantazy 2007, 56) Information Systems Flexibility ((Fantazy 2007, 56) Flexibility (Swink, Narasimhan, Kim 2005, 432) Flexibility (Butler, Ewald 2000, 12)	Delivery Logistics Speed (Morash 2001, 42) Delivery (Boyer, Lewis 2002, 19) Speed (Miller, Roth 1994, 289) Dependability (Miller, Roth 1994, 289) Broad Distribution (Miller, Roth 1994, 289) Delivery Speed (Krajewski, Ritzman, Malhotra 2009, 34) On-Time Delivery (Krajewski, Ritzman, Malhotra 2009, 34) Delivery Reliability (Morash, Lynch 2002, 37) Delivery Flexibility (Morash, Lynch 2002, 37) Logistics Productivity (Morash, Lynch 2002, 37) Delivery Speed (Morash, Lynch 2002, 37) Logistical Capability (Kim 2006, 1089)
	Relationships Supply Chain Relational Capabilities (Lado, Paulraj, Chen 2011, 205-206) Marketing Management Capability (Rangone 1999, 235) Advertising (Miller, Roth 1994, 289) Market Linking Capability (DeSarbo, Di Benedetto, Song 2007, 107) Marketing Capability (DeSarbo, Di Benedetto, Song 2007, 107) Innovative Marketing (Kim 2006, 1089)

Today, through the introduction of the Internet, capabilities have elevated for all and thus supply chains have become more integrative than ever. Effectiveness of the system does not rely on any group of activities or the performance of a single entity, but rather if the entire system can deliver effectiveness. (Lu, Petersen, Storch, 2007, 708-709.) Capabilities have the potential of being more durable than the resources those capabilities are built upon, due to the possibility of progressively replacing the underlying resources (Grant 1991, 124).

It is important to note that although capabilities are an important factor when determining competitive advantage, the strategy integration, a moderating factor between operations, capabilities and performance has a central role in binding capabilities together to increase performance and further build capabilities. It connects intra-organizational units together and aligns the programs and objectives with internal and external requirements. (Swink, Narasimhan, Kim 2005, 428, 447.) There needs to be a fit between supply chain strategy, related capabilities that facilitate the execution of that strategy, and performance. Cost leadership strategy is hard to succeed in due to the fact that only one or

two companies in an industry can achieve this. Conversely differentiation through customer closeness can be achieved through various different ways by exploiting many different capabilities. What differentiates excellent supply chains from mediocre is the proactive use of capabilities to solve problems before they even arise. (Morash 2001, 50-51.) Capabilities should be included in the planning and implementation of strategy, not only from the perspective of a single company itself, but from the perspective of the entire supply chain (Hofmann 2010, 265).

When it comes to capabilities, managers agree that all capabilities are important but subtle trade-offs need to be made when developing capabilities. When trade-off situations arise, it is critical for all decision makers to understand the overall strategy, so that concentrating on certain capabilities enhances the company's ability to follow its strategy. (Boyer & Lewis 2002, 18.) A major factor in relationship between capabilities and performance is that acquiring additional capabilities through purchasing or developing them in-house does not necessarily mean increased financial performance. Rather, exceptional performance comes as a result of exploiting and utilizing capabilities already at hand better than competitors do. (DeSarbo, Di Benedetto, Song 2007, 120.)

Capabilities however, are not the only requirement for excellent performance. Even if a company possesses excellent capabilities, it still needs to align itself with its supply chain partners and coordinate actions together in order to translate the capabilities into performance. Of course collaborative relationships with supply chain partners is not necessarily easy, and always includes risks. Too much integration, for example in the form of joint investments may reduce bargaining power each side has, so operating based on short-term lease basis is more advisable. This can be called arms-length integration, which enables critical integration but in more flexible way. (Kim 2006, 1101.) Facets that have a profound effect on supply chain capabilities include planning and partnerships, but also public policy imposed on the supply chains. All of these facets have an effect on reliability and speed, costs and flexibility, and are rather universally valued throughout the world. (Morash & Lynch 2002, 42-43.)

Dynamic capabilities have also been mentioned to be important for creating and sustaining competitive advantage for supply chains. The reason for this is that the definition of capabilities was originally built upon the notion that the business environments are stable and there is little innovation going on. Static capabilities were seen very difficult for competing companies to imitate, thus giving sustainable competitive advantage over time. (Defee & Fugate 2010, 182, 186.) Dynamic capabilities have been defined as "a learned and stable pattern of activities through which the organization systematically generates new static capabilities and/or modifies existing capabilities" (Zollo & Winter 2002, 340). This does not mean that static capabilities are useless, but rather emphasizes their effectiveness through the speed at which they can be re-configured and upgraded utilizing the dynamic capabilities (Defee & Fugate 2010, 187). This paper however will not go

into dynamic capabilities but rather tries to explain the dynamic changes companies go through by the means of adaptation.

2.5 Adaption

In order for supply chains to perform the best way possible, they need to adjust themselves to the surrounding market, or in other words – adapt to the surrounding business environment. Essentially adaptation is change to better fit with the surrounding environment. As the supply chain configuration depends on the market characteristics as well as on the surrounding actors they differ from company to company greatly. (Srai & Gregory, 2008, 405.) As mentioned earlier, a combination of agility, adaptability and alignment as suggested by Lee (2004) leads to increased supply chain performance, which then leads to increased performance of the overall organization. Improved performance of the supply chain also leads to increase in the marketing performance of the company. (Whitten, Green, Zelbst 2012, 40-41.) Adaptation alone has been shown to increase a number of different performance metrics. To start with, adaptation has been shown to increase operational performance (Nyaga, Lynch, Marshall, Ambrose 2013, 58) as well as export performance (Zaiem & Zghidi 2011, 305). Supply chain adaptation can also be used for reducing risks involved in doing business (Ellegaard 2008, 427). From the perspective of 3PL providers, adaptation has been shown to have positive effects on both the perceived relationship quality, provider satisfaction, as well as on performance. (Large, Kramer, Hartmann, 2011, 833-835.) We can safely assume adaptation has many benefits that supply chains are able to reap. In addition to supply chains engaging in adaptation regarding the business environment in general, individual organizations also engage in a dyadic adaptation in relationships between two organizations.

Surprisingly, the costs associated with adaptation, as well as estimates regarding the benefits of adaptation, are rarely calculated. Decisions are made rather intuitively, exception being situations where major fixed capital investment is required, in which case standard capital budgeting tools are employed. All this means that in many cases, opportunities that emerge from adaptation are overlooked. (Schmidt, Tyler, Brennan, 2007, 535.) When operating in foreign markets, managers have often been found to be under-adapting. This is called status quo-bias, in which managers typically adapt their strategies to a much lesser degree than needed if they want to maximize profits and performance. This is troublesome since the question has never been about whether or not to adapt, but how much to adapt. (Dow, 2006, 212, 222.) Overall, doing business in emerging markets and finding the right strategy that aligns well within the supply chains operations is often very hard for Western companies to reach (Moser, Kern, Wohlfarth, Hartmann 2011, 796-

797). For third party logistics (3PL) providers, again, adaptation is initially seen in a negative light and is associated with dissatisfaction, but as the adaptation process goes on, the provider tend to realize the positive effects of adaptation. Thus, customers should encourage 3PL providers in initiating customer specific adaptation. (Large, Kramer, Hartmann, 2011, 833-835.)

From the perspective of network size, smaller supply chains are found to be more adaptable and persist over longer periods of time if their network connections are stable and fixed over a period of time. For larger supply chains this has been found to be completely the opposite, since they tend to be more adaptable and persistent over time if their network connections are constantly changing, meaning members are constantly entering and exiting the supply chain. (Hearnshaw & Wilson, 2013, 461.)

In addition to managerial tendency to under-adapt, there is a tendency for managers to neglect adaptation that does not concentrate on tangible issues. This means that adapting logistics, product or the production process is relatively commonplace, whereas adaptation regarding human resources, organizational behavior as well as organization structure changes is often under-valued. Investments in adapting human resources and organization structure are generally motivated by the desire to build trust, or by the desire to make strategic investment in a dyadic relationship. (Schmidt, Tyler, Brennan, 2007, 535.)

In addition to supply chains engaging in technical adaptation, behavioral adaptation is also a factor in the adaptation process. The behavioral aspect of adaptation can be presented using three different dimensions: cognitive, relational and structural sub-dimensions. Cognitive dimension refers to the common mental model amongst the participating members in two organizations engaged in dyadic adaptation, developed to recognize, understand and share the value creation process from the resources available to both organizations. The relational dimension of adaptation refers to the attitudes, motivations and expectations of the participating members in the adaptation process. The structural dimension of the adaptation refers to the organization structure and the points of connection that the organizations share in their adaptation process, as well as the quality and level of the relationships of the connections between the two organizations. (Knoppen & Christiaanse, 2007, 222.)

Good ongoing relationships contribute to successful adaptation process. It is important to note that adaptation is not necessarily built on contracts, but rather on mutual trustworthiness and commitment. (Canning & Hanmer-Lloyd, 2002, 631.) In order for supply chains to be successful in their adaptation processes, they must be able to motivate the partner companies to engage in the adaptation process, they must be able to effectively manage the process itself, and finally they must be able to support the adaptation process. (Canning & Hanmer-Lloyd, 2001, 236.) Adaptation is also important from the perspective of customer satisfaction due to the fact that the drivers of customer satisfaction are found to be multi-dimensional, where adapting to customer needs together with communication,

trust and cooperation are essential in building customer satisfaction. (Cambra-Fierro & Polo-Redondo, 2008, 220.)

It can be said that supply chains pursue different methods of adaptation to reach different goals. Adapting to changes is too often very reactive and not a proactive process. This culminates when adaptation is seen as a reaction to a problem, rather than as a relationship development in a positive way. (Schmidt, Tyler, Brennan, 2007, 535.) Loyalty towards the existing supply chain partners has been seen to show commitment as well as stability, which in turn has a positive effect on the willingness of supply chain partners to engage in adaptation (Ellegaard 2008, 428).

In order for adaptation to occur in business relationships, interest for adaptation from one party is not sufficient. The interested party has to convey their partner to engage in the process of adaptation as well, meaning they must generate partner interest in the adaptation process. The threshold of interest required to generate depends on the level of expertise or awareness on the potential benefits the adaptation process might bring. (Canning & Hanmer-Lloyd, 2002, 623-628.) Reputation and expertise have also been shown to increase the other party's willingness to adapt (Nyaga, Lynch, Marshall, Ambrose 2013, 58). After the initial interest of both parties is at high enough level for adaptation process to takes place, it follows a sequence of events presented in Figure 4 below.

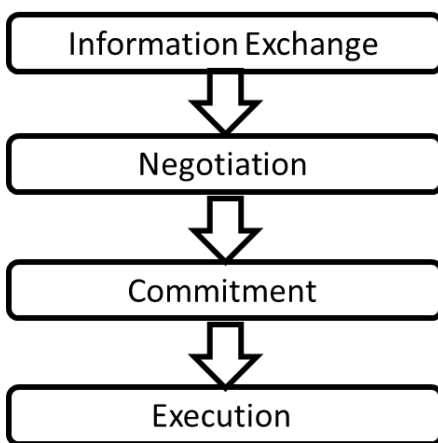


Figure 4 Progression of Dyadic Adaptation (Canning & Hanmer-Lloyd, 2002, 623-628)

Information exchange, especially through interpersonal contact serves many purposes, but in particular enables a number of prerequisite steps that eventually lead to adaptation. In many cases, managers in both organizations are not completely familiar with the macro-economic or micro-economic drivers of adaptation, in which case the goal of information exchange is the familiarization of managers to the situation at hand. This leads

to, and is a prerequisite for any adaptation, that both parties understand the nature of the problem at hand and agree on the issues that are to be addressed. Without a joint understanding of what needs to be done, engaging in adaptation is impossible. Once this is clear, both parties bring to the table whatever resources they have access to that can help facilitate the adaptation process. After information exchange and determining the problem and the resources available, negotiations will determine the use of these resources. After this phase of the process the only prerequisite for the adaptation process to take place is commitment from both parties to the result of the negotiation process. Once both parties have committed to the planned adaptation, the actual adaptation process may take place. (Canning & Hanmer-Lloyd, 2002, 623-625.)

The process of adaptation is dependent on both parties willingness to further continue with the relationship, which in turn is affected by the satisfaction of each party both in the process and one another. Individual manager's interest plays a role in the success of the adaptation process through the fact that the more positive view a manager has on his or her exchange partner, the more willing they were to move forward with the adaptation process. Managers own behavior and especially the perception of the partners' commitment, credibility and commitment all affect the adaptation process. In addition to perception of the partner and the process affecting the satisfaction with the adaptation process, the potential end results also affects managers' satisfaction with the adaptation process. To conclude, the more satisfied managers are with their partner, the process and the potential end result, the more likely the adaptation process is to take place. (Canning & Hanmer-Lloyd, 2002, 626-629.) It is thus apparent that when organizations are engaging in adaptation processes, the behavior and experience of the managers directly involved with the customer or supplier organizations during the adaptation process, have a significant effect on the end result. (Canning & Hanmer-Lloyd, 2001, 233.)

Cultural differences can also have considerable negative effects on business relationships between international companies. Cultural adaptation, a form of international inter-firm learning process where both parties try to adapt to each other's cultural background, has been suggested as a possible solution for this problem. In the context of Western-Chinese business relationships, cultural adaptation between two parties has been found to have a probable direct causal link to added mutual benefits experienced in the relationship. These mutual benefits include cost-reductions, relationship effectiveness, flexible adaptation, collaboration, commitment, trust, and guanxi quality, which is discussed later. (Jia & Lamming, 2013, 534,535, 546.)

Power is also a factor when it comes to adaptation. Dominated relationships generally produce unilateral adaptation. The presence of behavioral adaptation may however lower the effects of power on adaptation. (Knoppen & Christiaanse, 2007, 234.) The effects of power on technical and behavioral adaptation are presented in Figure 5 below.

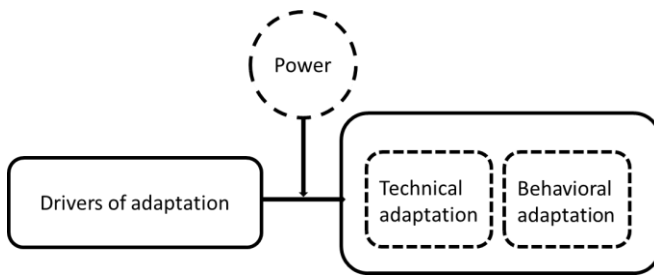


Figure 5 Power and The Drivers of Adaptation, Adapted (Knoppen & Christiaanse, 2007, 222)

There are many sources of power companies can exert, which are perceived in a positive, neutral or negative ways. Non-mediated source of power refer to power gained through expertise power and referent power and are perceived as positive sources of power. Possessing expertise power means that a company has specific expertise which can be useful for the partner. Referent power exists when the way a company operates is admired by others and working together with that company is perceived to create value either directly though better operational efficiency or indirectly through gained reputation that may be used as a reference. Mediated sources of power are generally perceived more negatively, and include coercive power in which a company has the means of punishing another company, legal legitimate power in which a company has the means to coerce others though legal contractual means, and finally reward power in which a company has the means to reward another company. Rewards are the only form of mediated power that is perceived in a positive way. Supply chain partners tend to engage in dyadic adaptation only if they have to. However using expertise power and reference power can increase the willingness of the supply chain partner to engage in adaptation. With high-value partners however wielding expertise and reference power might not be enough, but a protocol of formal incentives needs to be put in place in order to motivate the other party. Coercion by contrast has the opposite effect and can be counterproductive. The strongest factor contributing to adaptation behavior is the perceived relationship quality. It also has an effect on collaborative behavior and even operational performance. Communication between partners in a high-quality relationship is better and necessary adaptation is engaged more easily. Relationship quality also reduces the effects of power asymmetry, which creates uncertainty as well as vulnerability to the party with less power. Thus it is evident that companies need to make sure to invest in relationships quality (Nyaga, Lynch, Marshall, Ambrose 2013, 47, 58-59).

According to Supply Chain Volatility index developed by Christopher and Holweg, supply chain volatility has increased over the last few years and we are entering a new age of more turbulence in the business environment. Supply chains need to adapt in order to become more flexible so that they will be better equipped for both economic upturns and as well as downturns. (Christopher & Holweg 2011, 65, 80.) Speed of the adaptation

process can be regarded as a competitive advantage (Militaru & Zanfir, 2014, 146). Especially in a turbulent and hostile environment, it is absolutely vital for a supply chain to be able to adapt if it is to survive. Adaptation and the need to adapt are always contextual to the surrounding environment. In many cases the adaptation required is related to the marketing function in the form of product mix. The extent to which company possesses the ability to adapt is a competence or a resource specifically acquired through learning, prior investments or competition. Unpredictability and uncertainty forces the entire supply chain to adapt. (Dreyer & Grønhaug, 2012, 1274.)

Two major motivators for adaptation are uncertainty and costs. Uncertainty is derived for example from the surrounding legal system and from the market dynamics (Canning & Hanmer-Lloyd, 2001, 229), i.e. macro and meso-drivers of adaptation. Macro-drivers of adaptation are drivers that contribute to the need and willingness of a company to adapt that are drawn from the macro-economic environment and changes in that environment. Conversely meso-drivers are industry wide and micro-drivers case-specific drivers of adaptation that are drawn from their respected level of environment and change. (Knoppen & Christiaanse, 2007, 222.) Companies can try to alleviate uncertainties mentioned above by proactive adaptation. Cost improvements are another motivator which also contributes to the adaptation process. (Canning & Hanmer-Lloyd, 2001, 229.)

Supply chains today face the challenge of increasing complexity, which can be divided into two categories: internal and external complexity. Internal complexity refers to complexity related to the internal workings within an organization, such as process configuration, products, technology, and organizational structure. External complexity relates to the facets of the business outside the organizations boundaries, meaning product demand in the market place, customer base in the market place and in some cases available logistics solutions. It has to be noted that product is related to both internal and external complexity due to the fact that products and product lines are affected by both the internal workings of an organization through decision as to what products and product ranges a chooses to produce as well as the outside market in the form of demand for each type of product. The third dimension is the strategic configuration of an organization. This acts as a mediator between external and internal complexities and sets up the basic parameters by which an organization operates. Strategic configuration aims to combine cost, quality and flexibility in the most efficient way possible. Changes in the external and internal complexities might change the strategic configuration of an organization so that it fits better to the existing markets through implicit and explicit adaptation. (Größler, Grübner, Milling 2006, 256-258.) The need for adaptation can also change over time. Therefore managers need to pay constant attention to changes in the markets so that they can apply the most effective measures. (Brei, D'Avila, Camargo, Engels 2011, 280.)

When the complexity of the operating environment increases, organizations have three different means of adapting to those changes. These adaptation models are explicit adaptation, implicit adaptation and a mixture of the two. Explicit adaptation means that organizations adjust their strategy and set-up in order to counter the external changes in complexity in the most effective and efficient way possible. Implicit adaptation means that there are built-in components in the system that autonomously reacts to the changes in the operating system, relieving the management of making explicit adaptation. A mixture of the two adaptation models has to be used when implicit methods of autonomous adaptation exist but are not sufficient to counter the external changes. In these cases the implicit adaptation process must be enhanced with explicit adaptation.

Organizations and supply chains that operate in higher complexity environments have already developed means and measures to cope with external complexities using internal means such as flexible processes, technology and organizational structure. Explicit adaptation as such is not required because their internal flexibility is able to buffer external changes. Implicit adaptation is somewhat needed in order to maintain the flexibility in a complex environment. Changes that do happen are related to the strategic configuration of the organization but are not necessarily formulated as such but emerge from the small adjustments made over time and from the resulting behavior by the individuals and parts of the company. (Größler, Grübner, Milling 2006, 258, 272-273.) This is shown in Figure 6 below.

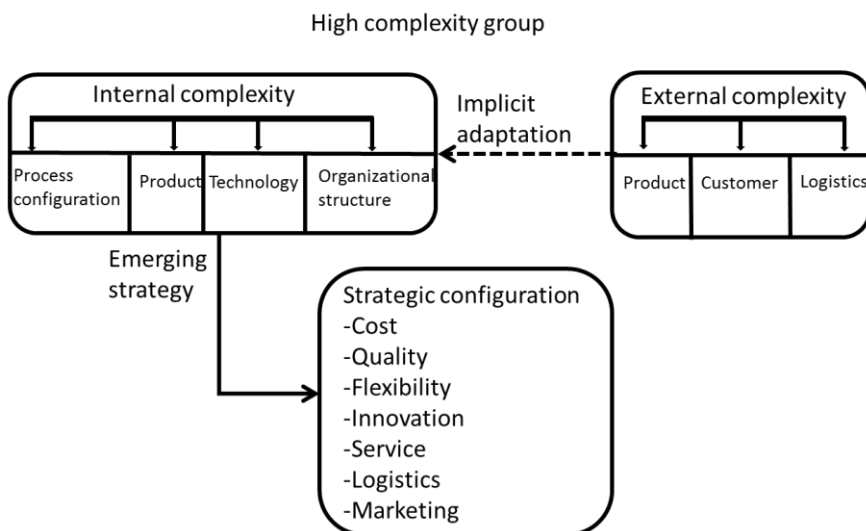


Figure 6 Adaptation in High Complexity Environment, adapted from (Größler, Grübner, Milling 2006, 258, 272-273)

On the other hand organizations that operate in low complexity environments have to react to external complexity by increasing internal complexity, which results in both implicit and explicit adaptation. The reasoning behind this is that organizations that have operated in low complexity environments are not used to adapting to their environment, so once the threshold for adaptation being necessary is reached, they have to adapt more

both implicitly and explicitly, as well as adjusting their strategic configuration. This raises an issue for companies that have not been required to deal with complex environments in the past. (Größler, Grübner, Milling 2006, 272-274.)

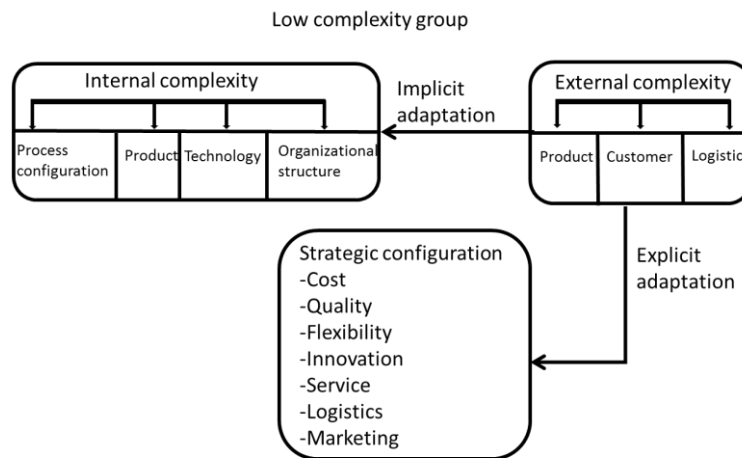


Figure 7 Adaptation in Low Complexity Environment, adapted from (Größler, Grübner, Milling 2006, 272-274)

In cases where external complexity increases significantly, they must take drastic action due to the fact that their internal structures are most likely not capable of handling the external complexity (Größler, Grübner, Milling 2006, 272-274). In this thesis the adaptation of organizations to complexity is extrapolated to cover supply chains, as the same rules, regularities and context can be scaled upwards and applied to examine the adaptation of supply chains.

Many supply chains today are not adaptable due to the fact that they are engineered to cope with turbulent environment through control, and not by embracing the turbulence. Figure 8 illustrates the change that occurs in design and objectives of supply chains in order to become more adaptive. The two key variables in the chart are dynamic flexibility and structural flexibility, both of which need to be at a high level in order for a supply chain to become adaptable. Dynamic flexibility refers to flexibility individual companies have, but limited to within their existing supply chain configuration and set-up. Structural flexibility refers to flexibility in the actual supply chain design. (Christopher & Holweg 2011, 64, 70.)

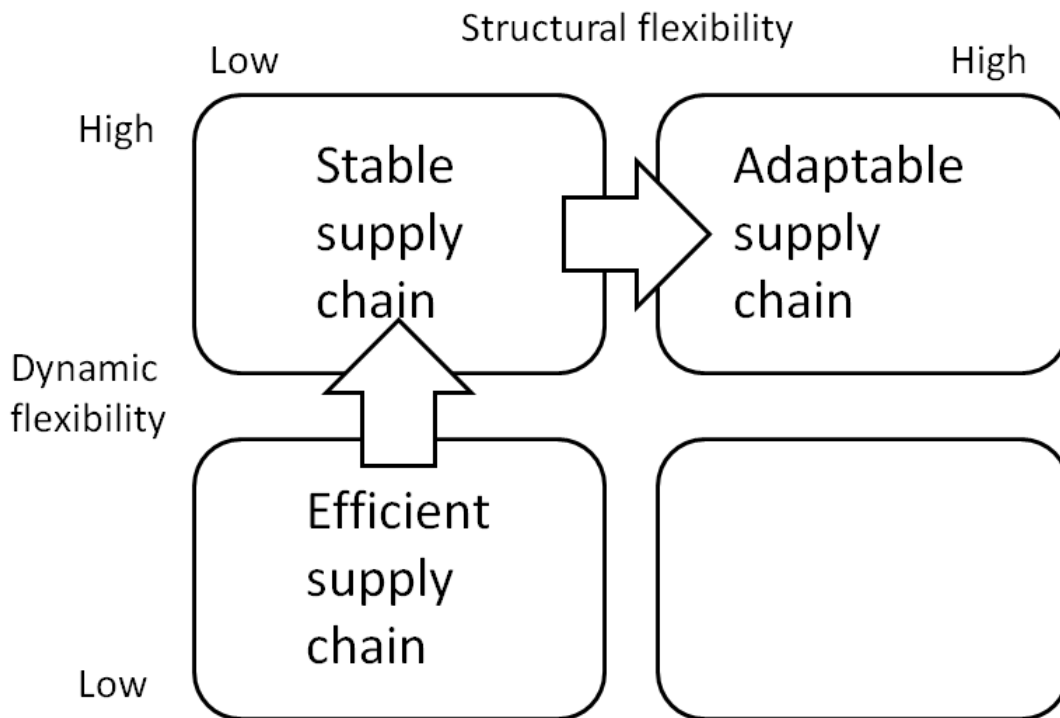


Figure 8 Supply Chain Dynamic and Structural Flexibility (Christopher & Holweg 2011, 70)

Efficient supply chains are geared towards control, which they utilize to counter variability and to lower costs. Turbulence is viewed as a negative thing that causes instability and increases costs. Thus to better be able to counter turbulence, supply chains need to increase their dynamic flexibility in order to better be able to counter turbulence. The ultimate goal however, is addition to also have structural flexibility, which is achieved through a set of actions. (Christopher & Holweg 2011, 70.)

- Dual sourcing, in which a company sources the key components and materials to multiple producers
- Asset sharing, including manufacturing capacity, logistics and distribution, sometimes even with competitors
- Separation of base demand from surge demand, which means recognizing the base demand for a product or a service that varies minimally, and surge demand that can be dealt with postponement strategies
- Postponement, meaning that products are not fully assembled until at the very last minute in order to reserve the possibility for potential changes
- Flexible labor arrangements, in which employee hours are calculated annually instead over shorter periods of time or by using agency personnel
- Rapid manufacture, in which the goal is to set up more of smaller more flexible facilities of production, enabling dispersed production

- Outsourcing, in which the idea is to change fixed costs into variable costs through contract manufacturing as well as by utilizing third-party logistics

By adhering to these principles, companies are setting up their supply chains in a way that makes them more adaptable both through dynamic flexibility as well as structural flexibility. (Christopher & Holweg 2011, 70-72.)

As a conclusion, many factors affect the adaptation process. The factors affecting adaptation can be divided into four groups based on their similarities. The first group is behavioral factors, which includes the perception and interest of individual managers involved in the process (Canning & Hanmer-Lloyd, 2002, 626-629; Canning & Hanmer-Lloyd, 2001, 233), as well as the perception of the relationship quality between business partners (Canning & Hanmer-Lloyd, 2002, 631; Ellegaard 2008, 428; Nyaga, Lynch, Marshall, Ambrose 2013, 47, 58-59). Mutual interest is required in order to begin and also to proceed with the adaptation process (Canning & Hanmer-Lloyd, 2002, 623-628; Schmidt, Tyler, Brennan, 2007, 535; Canning & Hanmer-Lloyd, 2001, 236). Attitudes regarding the motives of adaptation have an effect on the quality and content of the adaptation process (Schmidt, Tyler, Brennan, 2007, 535). Culture also has an effect on the adaptation process (Jia & Lamming, 2013, 534,535, 546). It is worthwhile to mention that all of these facets of behavioral factors affecting adaptation can act as a hindrance or enhancement of the adaptation process. The typology regarding the drivers of adaptation is presented in Table 2 below with corresponding authors and drivers.

Table 2 Typology of Drivers of Adaptation

Behavioral factors
Individual Managers (Canning & Hanmer-Lloyd, 2002, 626-629), (Canning & Hanmer-Lloyd, 2001, 233)
Relationship Quality (Canning & Hanmer-Lloyd, 2002, 631), (Ellegaard 2008, 428), (Nyaga et al. 2013, 47, 58-59).
Mutual Interest (Canning & Hanmer-Lloyd, 2002, 623-628), (Schmidt, Tyler & Brennan, 2007, 535), (Canning & Hanmer-Lloyd, 2001, 236)
Attitude (Schmidt, Tyler & Brennan, 2007, 535)
Culture (Jia, Lamming, 2013, 534,535, 546)
Power factors
Power (Source Mediated or Expertise) (Knoppen & Christiaanse, 2007, 234)
Size (Hearnshaw & Wilson, 2013, 461)
Reputation (Nyaga et al. 2013, 58)
Cost (Canning & Hanmer-Lloyd, 2001, 229)
Uncertainty (Dreyer & Grønhaug, 2012, 1274), (Canning & Hanmer-Lloyd, 2001, 229)

The second set of factors that affects adaptation is power factors. These naturally include the amount of perceived negotiation power, as well as the source of power. Both the amount and source of power have a qualitative effect on the use and effects of power in a business relationship. (Knoppen & Christiaanse, 2007, 234.)

The third factor affecting the adaptation process is costs. Naturally companies strive to achieve lower costs in order to increase their profits as well as to better their positions in the markets. This leads to them adapting their resources and capabilities in order to achieve lower levels of costs. (Canning & Hanmer-Lloyd, 2001, 229.)

The last factors affecting adaptation is uncertainty. Is generally derived from the surrounding institutional environment supply chains are operating in, for example through legislation, changes in the political environment, and possible changes in the markets and so on. Stable environment generally pose less uncertainty, whereas especially emerging markets pose more instability and thus uncertainty. (Dreyer & Grønhaug, 2012, 1274), (Canning & Hanmer-Lloyd, 2001, 229.)

The drivers of adaptation were identified and a typology was created, which is presented in Figure 9 below.

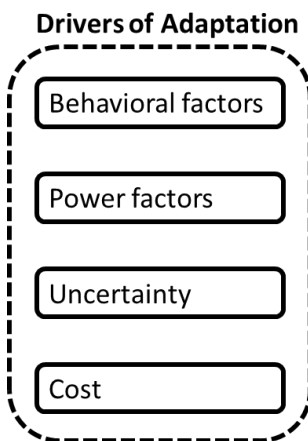


Figure 9 Drivers of Adaptation

Based on the literature review these are the main drivers and exhibit the initiation of adaptation process regarding resources and capabilities companies have in order to form a better fit with their surrounding business environment and increase their performance.

2.6 Theoretical Model

A theoretical model was created based on the literature review to depict the resources and capabilities supply chains possess, as well as the institutional environment supply chains operate in. The model also depicts how the institutional environment affects both the resources and capabilities and forces supply chains to engage in adaptation to form a better fit with the surrounding business environment. The model is shown in figure 10 below.

The basis of the model is based on combining the resources and capabilities as means of understanding the functioning of an organization (Grant, 1991, 118-122), together with how the institutional environment affects supply chains, especially in emerging markets (Khanna, Palepu, Sinha 2005, 9-14).

In this model, supply chains exhibit capabilities, which are the product of coordinated effort of combining resources together. Resources themselves are rarely productive on

their own, but when combined together in meaningful way, will create capabilities. Grant's (1991) typology of six key resources was used to depict the different resources supply chains possess to create capabilities. By adapting supply chain controlled resources, possible capabilities that supply chains can exhibit will change accordingly, as it becomes possible for companies to perform better on certain capabilities. For example investments in physical resources, such as production facility or logistics network would increase supply chains delivery capability, but likely modifications to other resources would need to be made accordingly (Grant 1991, 118-122).

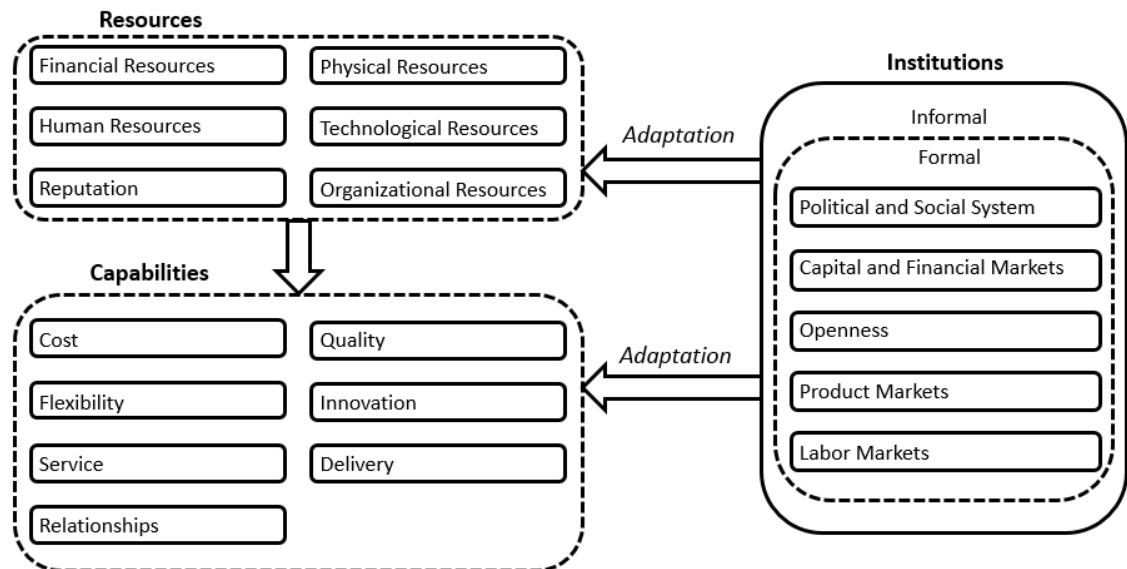


Figure 10 Theoretical Model

As mentioned earlier capabilities are created from the coordinated use of resources and result in predictable patterns of organizational sequential routines of interactions between resources in an organization. A typology was created to depict the seven different capabilities companies possess in a holistic view to get a better understanding of the how the company as a whole operates. This typology contains seven distinct capabilities, which are aimed to depict the most essential capabilities in order to give a clear and holistic view over a given company's workings. The typology is based on the works of Morash (2001), Boyer & Lewis (2002), Rangone (1999), Miller & Roth (1994), Krajewski, Ritzman & Malhotra (2009), Swink, Narasimhan & Kim (2005), (Morash & Lynch (2002), Kim (2006), Butler & Ewald (2000), Fantasy (2007), DeSarbo, Di Benedetto & Song (2007) and Lado, Paulraj & Chen (2011).

The typology for institutional environment affecting supply chains was created based on Khanna, Palepu and Sinha (2005), which depicts the institutional environment based on five key components, adding the formal and informal aspects of institutions to the model. This typology is used to map the institutional environment of a specific market, including the potential institutional void, or the lack of properly functioning institutions

in order to get a clear understanding of the business environment as a whole. (Khanna, Palepu, Sinha 2005, 9-14.) Institutions then have an effect on resources and capabilities, which are then adapted accordingly in order to find the best strategic fit with the focal company and its business environment.

The aim of this model is to capture the critical resources and capabilities supply chains possess in emerging markets, as well as the adaptation process that takes place as companies are trying to find the best strategic fit by changing the resources and capabilities accordingly. This model will be the theoretical basis for the examination of Finnish companies supply chain operating in China.

3 CHINESE INSTITUTIONAL ENVIRONMENT

The aim of this chapter is to examine literature regarding the institutional environment in China. This is important, as the institutional environment, and the underlying social and political system in particular, differ from Western societies greatly. This chapter contributes to the understanding of institutions and is later reflected with the interview data in order to gain a more complete understanding of the institutional environment in China. This is important as the institutional environment affects Finnish companies supply chain management and how they adapt in order to find a strategic fit with the surrounding institutional environment.

3.1 History of China

In order to understand China as a business environment, we must first take a glance to the past, which still affects modern day China. During the Era of Warring States (403-221 BC) China was divided into seven states that were fighting over dominance. It was during this period when Sun Tzu, a military strategist wrote his book, *The Art of War*, which is still considered a fundamental piece of military literature, applicable even to modern business management (Wu, Chou and Wu, 2004, 397, 406). Eventually the Qin state (221-206 BC) was successful in conquering all other states, began a dynasty and formed one state that we now call China. Reforms were made to unify the former states, for example by unifying the writing systems as well as setting standard weights, measurements and currency. Succeeding the Qin dynasty 秦朝, the Han dynasty 漢朝 instituted new reforms and also established the principles of Confucius (551–479 BC). Confucius was a philosopher who had developed a base for social order and governance that affects China until today (Fairbank & Goldman, 2006, 51-56). The historical importance of these events is significant. The establishment of a single state and later unification by the Qin dynasty formed the basis of the idea of a single country, rather than smaller independent ones. This legacy still lives on. The Han dynasty on the other hand has affected China significantly more, since the vast majority of Chinese people categorize themselves as Han Chinese, and even Mandarin Chinese language is often referred to as Han-language (汉语 / 漢語). From the perspective of business environment, the most significant effects of the era of warring states is the adoption of the teachings of Confucius, which can be seen even today and still form a basis for many of the business practices in China (Jacobs, Gao, Herbig, 1995, 34). Confucian principles have had an effect of the formation of the concept of *guanxi* (关系), through moral behavior, social modes and social basis. *Guanxi* influences the Chinese society as well as economy through social-political life as well as business-economic activities (Kaunonen, 2013, 84).

Since the fall of the last Chinese imperial dynasty, the Qing dynasty 清朝, in 1911, China has seen political upheaval, civil war, occupation and finally in 1949 the Communist party coming to power. The economic miracle of China was made possible when the chairman of the communist party Mao Zedong died and Deng Xiaoping started leading the country into a new direction. Despite Deng not being formally in power, he was the paramount leader of China until his death in 1997. His reforms began soon after Mao's death and were officially declared in 1978 as the Third Plenum. The program was called "Socialism with Chinese characteristics" establishing China moving into free-market economy and opening up to international trade while maintaining the communist single party system. The goal was to take advantage of Western technology and economic model while still adhering to Confucian state and values. (Fairbank & Goldman, 2006, 406-408.) Over the next two decades, the rise of China will possibly be the most significant megatrend in world economy. Despite the growth rates of Chinese economy being projected to slow, it has been estimated that China will replace the United States as the world's largest economy by 2030, in which case its share of world trade would be twice the size it is now and provided that the trade surplus will remain as it is, it will also be the world's largest creditor. (World Bank, 2014, 6-7.)

Over the last few decades, China has become one of the major players in the global economy. Since the economic reforms in the late 1970's, China has grown 10% every year, fastest in the entire world (World Bank) quadrupling the per capita incomes since 1978. (Fairbank & Goldman, 2006, 406.) Over the last three decades some 500 million people were lifted from poverty, which fell from 65% to less than 10% of the population. Average household incomes have increased both on the countryside as well as inland on average 7 percent annually, although heavy regional differences exist. The major cities on the eastern coast are obviously the most developed areas, major cities inland coming in second and rural areas further away from the coast lagging behind. (Lin, Zhuang, Tang, Lin, 2008, 1.) In 2013 China even surpassed the United States as the largest trading nation in the world (Finpro, 2014) and became the world's largest manufacturer in 2008 (World Bank 2014). China even survived the global financial crisis practically better than any other OECD country and continues its rapid growth (OECD, 2013, 13).

The difficulty of entering China lies in the combination of having to understand Chinese culture, paired with handling government and legal issues, making market entry a truly complex issue even for large multinational corporations with plenty of wealth and professionalism at their disposal. (Wilson & Brennan, 2009, 653-654.) In order to understand Chinese business environment, one needs to understand Confucianism and how it relates to the Chinese society as well as business environment (Jacobs, Gao, Herbig, 1995, 33-34). Confucianism also affects *guanxi*, which is deeply embedded in Chinese culture and way of life (Gong, He, Hsu, 2013, 374). Both of these concepts are important in this

thesis and will therefore be examined from the perspective Finnish supply chains operating in China.

3.2 Confucianism

The significance of Confucianism cannot be understated in Chinese society. For centuries the Chinese ruled their vast land areas through government officials who were recruited into office after passing a civil service examination that was based on the teachings of Confucius. (Lehman, 2006, 4.) Despite the communist attempts to replace, suppress and even purge Confucian thought in favor of a socialist ideology and culture, Confucianism has recently gained popularity due to endorsement by many Chinese government officials. (Ip, 2009a, 473.) Foreign firms operating or investing in China have to deal with Confucianism for some time and must understand it in order to effectively formulate strategies. (Wong, Maher, Evans, Nicholson, 1998, 21.)

Confucianism is based on four main ideas: harmony, hierarchy, the building of moral potential and kinship (Buttery & Wong, 1999, 149). In order for harmony to exist in the society, people need to know their place and how to behave. Confucius defined the Five Cardinal Relationships or wulun (五伦) which are between the ruler and his subject, between a father and his son, between a husband and his wife, between an elder brother and his younger brother and finally between a friend and his friend. Following correct interpersonal relationships and manners or Li (礼) will bring stability and security. (Kaunonen, 2011, 62-63.)

The basis of personal development in Confucianism is in *jūnzǐ* (君子), translated as a superior man or sometimes as gentleman, a human with impeccable character, that is only achieved through earnest practice of humanity. Dependability, honor, trustworthiness and righteousness are associated with *jūnzǐ*. This comes with humility as well, because a person, who thinks he is always right, does not know right from wrong. (Sheh, 2010, 281.)

Chinese culture and its values are a very important factor in shaping Chinese organizations and even managerial and leadership practices to the extent that it has created distinguished characteristics of the Chinese managerial and organizational system. The basis of leadership is virtue rather than law. (Sheh, 2010, 280-281.) The management style of Chinese leaders emphasizes “stability in life, serenity of an organization and peace of a community” in order to instill harmony. The pursuit of “good career and good life” are important goals and everything that affects these things is considered under management, including incentives and punishments to the personnel, production method, marketing approach, and management itself. The goal of the management is to achieve stability of human minds, or harmony, progress of human beings and enhancing the concepts of good career and good life. The idea extends in a chain from a peaceful body and mind to a

peaceful family to a community with progress to a nation with wealth and peace in which people are living good lives with good careers. (Lin & Chi, 2007, 195.)

Many of the Confucian ethics have a lot in common with the Western ethics, for example in personal integrity, trust, justice, respect for others etc., which are very much universal concepts common to all people. Differences do however exist. For example the Western view over intellectual property rights differs that of a Confucian view. Westerners view intellectual property rights and innovations as private property because that way it preserves incentives to invest in innovation. The Confucian view emphasizes commonness of all that extends to even intellectual property rights and the responsibility of those who have the know-how to those without. In short, intellectual property is seen as common good for all to utilize because that is how all can benefit from it. A problem the Confucian view has, is that it encourages risk aversion, and thus has not been able to cope with the risk-taking mentality needed in innovating in a knowledge based economy. (Kit-Chun, 2003, 159-160.)

The Confucian heritage is present as “concern for moral worth, scholarship and education, hard work, goodness, humanistic love, justice and righteousness, wisdom, modesty, faithfulness, respect and loyalty for elders and ancestors, indifference to religion, quietism, reflections, suppression of worldly desires, collaborating, suspicion towards leisure and, avoidance of shame to self, family and nation through honest and hard work.” Managers see themselves as having a hierarchical paternalistic obligation to their employees and as a result the management style is done behind closed doors. The main goal however is harmony, rather than control. (Yazdani, Murad, Abbas, Gondal, 2011, 262-263.)

3.3 Guanxi

The two most critical factors for long term success in China, according to the Chinese, are Confucian values and guanxi (Keller & Kronstedt, 2005, 61). Although guanxi shares many similarities between some Western concepts, such as relationship marketing or networking, there are many fundamental differences between them, resulting from guanxi being a very unique Chinese social concept derived from Confucian cultural values and Chinese political and social systems. (Fan, 2002, 555.)

Guanxi is highly influenced by the legacy of Confucianism, due to the high regard for harmony and hierarchy. As a result harmonious interactions between people are valued and sought after. (Dunning & Kim, 2007, 331-332), (Chen & Chen, 2004, 307.) Due to the effects of Confucianism, the legal system of China is relatively weak, whereas guanxi between two individuals is very strong (Gao, 2006, 120) although there might be evidence

to suggest that guanxi might work as a complementary force rather than as an alternative to formal institutions (Dunning & Kim, 2007, 339).

The Chinese word guanxi (关系) refers to “drawing on established connections in order to secure favors in personal relationships” (Dunning & Kim, 2007, 329) or “particularized and personalized relationship based on the reciprocal exchange of favors” (Dong-Jin, Pae, Wong, 2001, 52). Building guanxi can be represented in three stages, presented in Table 3 below. There are three consequential stages of building guanxi, each including three variables; guanxi objectives that need to be reached, interactive behaviors and activities that help in achieving guanxi activities, and operating principles that underlie both the activities and objectives which moderate the relationship. (Chen & Chen, 2004, 310.)

Table 3 Stages of Building Guanxi (Chen & Chen, 2004, 310)

Guanxi Stage	Guanxi Objectives	Interactive activities	Operating Principles
Initiating	Setting up bases	Familiarizing	Mutual self-disclosure
Building	Enhancing quality	Expressive and instrumental transactions	Dynamic reciprocity
Using	Getting benefits and re-evaluating guanxi quality	Exchanging favors	Long-term equity

The objective of initiating stage of guanxi consists of setting up guanxi bases or finding something in common with the potential guanxi partner. Kinship and family are natural guanxi bases, but others exist as well. Common social identity is the first guanxi base, which in the Chinese culture is a rather fluid concept. (Tsang, 1998, 65.) Common birthplace, educational institution and workplace all contribute to a guanxi base, but for example in the case of a birthplace, approximate geographic proximity might be sufficient, in case of educational institution the two people do not have to be of the same class or even to have gone to school at the same time to claim common social identity. The second guanxi base is a common third party, someone you have guanxi with who introduces you to a potential guanxi partner. The third guanxi base is merely communicating intention or even a promise of engaging in future exchange, collaboration or joint venture. At this stage of building guanxi, familiarizing with the potential guanxi partner is the most important activity; sharing family and personal background as well as sharing common experiences, anything that could establish a common social identity base. No further guanxi may be created if guanxi bases are not found, and on the other hand finding common guanxi bases is not a guarantee further guanxi is developed. Operating principle of mutual disclosure is required, which means both parties need to be willing to self-disclosure, which in Eastern cultures might not be easily achieved. (Chen & Chen, 2004, 311-315.)

After finding mutual bases of *guanxi*, the two parties can start building *guanxi* through transactional activities. These activities are divided into two groups; expressive and instrumental transactions. Expressive transactional activities refer to activities social in nature, such as celebrations of marriage, birthdays and promotions. Instrumental interactions include more business and work related activities, such as work place cooperation, business transactions, information exchange etc. Both expressive and instrumental activities are aimed at affection and affective trust and on the other hand obligation and cognitive trust. The operating principle is dynamic reciprocity, which in case of Chinese society has a distinctive nuance in the form of favor exchanges, which is the most pervasive rule guiding the Chinese social and economic interactions. There is a long-term orientation to this reciprocity, since immediate repayment is often seen as closing, rather than opening the relationship. (Chen & Chen, 2004, 316.)

The final step is using *guanxi* and adjusting the quality of *guanxi*. Mostly this is done in non-routine problem solving situations that cannot be resolved by oneself or through normal channels. This is also a time for re-evaluating *guanxi* quality, due to the fact that asking favors is a test to the quality of *guanxi* relationship, of course depending on the significance of the favor. The operating principle is long-term equity, in which the response to the favor asked will determine the future status of the relationship. Naturally below expectations execution of a favor will create a feeling of inequity which may cause parties to drift apart, and vice versa beyond expectation response will cause a feeling of indebtedness. (Chen & Chen, 2004, 318.)

The quality of the *guanxi* relationship can be represented on levels of *guanxi*. Three different levels of *guanxi* exist, each of which is governed by different rules. The innermost circle consists of expressive ties, usually among family, kinship or *qinqi* (亲戚), as well as closest friends. In this circle the governing principle is need rule, which means that resources are allocated based on individual needs. The intermediate circle consists of familiar ties, *shuren* (熟人), or mixed ties, including with friends and people who are particularly close. In this circle the governing principle is *renqing* (人情) which means that the allocation of resources is done based on emotional response to the particular person in this circle. The outermost circle consists of instrumental ties, people who merely know each other, *renshi* (认识) and who seek to benefit from each other instrumentally. This circle is governed based on equity rule, where little or no emotional component exists and the focus is on rational decision making as well as reasonableness. (Chen & Chen, 2004, 312.) The three circles are presented in Figure 11 below.

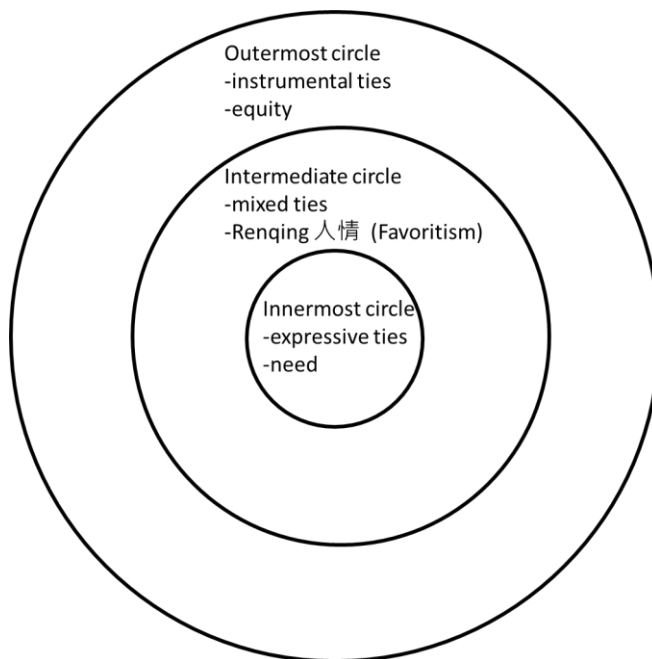


Figure 11 Circles of Guanxi, adapted from (Chen & Chen, 2004, 312)

In the context of Chinese and Westerners, it is vitally important that all actors must establish and understand their place in the three circles of guanxi. Once this is achieved, actors need to follow the rules of their circle they are positioned in. Progressing is possible through investment in interpersonal relationships with others. This is done both from business perspective as well as from social setting perspective, since there actually is no distinction. Developing these relationships takes time and is gradual as well as interactive, requiring acknowledgement from others. Complete control over others must not be the goal. Learning from others about the rules within the different circles and acquiring necessary resources and capabilities to engage in appropriate strategic activities should be done jointly with those who are in appropriate position to give advice. Difficulties arise from changing of the complexity of rules in different contexts. The rules vary from relationship to relationship, so in each new relationship, rules need to be explored and determined separately. Rules of the relationship may also change as the relationship changes so they need to be re-examined from time to time. (Gao, Ballantyne, Knight, 2010, 266,271.)

Guanxi has some very distinct properties, which are presented below.

- Transferability, meaning that when two people have guanxi, one may extend his guanxi to recommend a third person
- Reciprocity, meaning that returning favors is expected, and thus refusing to return a favor will cause the declined person to lose face
- Intangibility, guanxi exists over extended periods of time without written contracts, merely on basis of an unspoken promise
- Business, not emotional, meaning that if the relationship is not leading to results, guanxi can be severed

- Context, in some cases returning favors is considered proper, in some cases it may be considered bribery
- Long-term, establishing, cultivating and utilizing guanxi takes time and is considered a long-term relationship
- Personal; guanxi is not a group connection as such, but between two people

As visible from the characteristics, guanxi is not something that is created over a visit or two, but rather over longer periods of time. (Keller & Kronstedt, 2005, 62.) Westerners often struggle with the concept of guanxi and with the Chinese culture. There are many examples of failed business relationships and lost deals due to inability to understand guanxi. (Chua, 2012, 28.)

The simplest way for Westerners to start building guanxi is by first conquering the major obstacle many Westerners and Chinese have; lack of trust. The reason for this is that Western and Chinese views over trust are very different. Westerners tend to separate trust from head and trust from the heart. The trust from the head refers to reason-derived trust, belief in the reliability, skill and accomplishment of the other person. Trust from the heart on the other hand is reserved for social life and for home. It refers to social and emotional closeness, rapport and empathy. The Chinese see little separation between the two concepts of trust. The easiest way for Westerners to begin establishing guanxi is by starting to initiate the trust building process in two stages on two different levels. The first stage is to build trust from the head, or cognitive trust. Proving one's worth to an individual or to a network does this most effectively. One needs to add obvious value to the individual or to the network in order to instill cognitive trust, but often, emotional trust will follow. It must be pointed out, however, that this might take a considerable amount of time and effort before the Chinese counterparts will see the other party as trustworthy. The second stage is to build trust from the heart. Obviously this is an immensely complex process but in multicultural setting research has concluded that people with higher cultural metacognition skills are better at building rapport with people from other cultures. This means is that they constantly re-evaluate the biases and stereotypes they have about the surrounding culture and test them against reality. They are also more aware of their own cultural assumptions, which when proven wrong are modified into more accurate depiction of reality. Achieving rapport and trust on both levels will give better chances of forming guanxi in the future. (Chua, 2012, 29-33.)

Guanxi is sometimes compared to the Russian term blat. Similarly to guanxi, blat is the use of personal connections as well as informal contacts and networks in order to obtain goods and services that would otherwise be unobtainable, especially in cases of shortages. Blat practices are often disguised by the use of rhetoric of friendship, such as "helping out a friend", "friendly support" and "mutual care". Although blat and guanxi share many similarities, there are also differences. Guanxi is based on a moral code of

Confucianism that relies on the moral duty of reciprocity to almost ritualistic extent. To not return a favor would be unthinkable. Blat on the other hand is derived from the word *blatnoi*, criminal jargon, and as such has a very negative connotation. Although blat has the elements of helping a friend, it still has the underlying meaning of wrongdoing. (Ledeneva, 2008, 126-128.) Blat has lost its warm “human face” and become materialized, as well as something very negative in connotation with criminal undertones (Michailova & Worm, 2003, 517). In *guanxi*, where the necessity of reciprocity is absolute, whereas in blat it is more ambiguous, relying on “the feel for the game”, as well as being more opportunistic. After the fall of socialism, blat has changed in size and scope, becoming less pervasive but actually growing in size. It is practiced by a small elite of businessmen, government officials and criminal underground. (Ledeneva, 2008, 126-128,133.) It is worthwhile noting that blat came to exist as a result of the socialist system and the shortages the socialist system created (Ledeneva, 2008, 140), whereas *guanxi* is a result of the Confucian code. For this reason *guanxi* also exists in Chinese communities outside of Peoples Republic of China. For example in Taiwan, *guanxi* is even more profound than in Mainland China. (Lin, 2011, 441.)

As it can be easily understood, due to the cultural differences as well as the difficulty of grasping the concept of *guanxi*, it is quite difficult for Westerners to engage and succeed in building *guanxi* relationships. As they are important however, this should not deter Westerners from trying to build good relationships with their Chinese counterparts.

3.4 Guanxi as a Competitive Advantage

Guanxi, once established has been shown to affect positively on a firms decision making process and to negatively affect opportunism. It increases the perception of relationship quality and interdependence, which then positively affects business performance. In situations with high-degree of decision making uncertainty, it is thus advisable to concert efforts to establish and develop *guanxi* with Chinese business partners. (Dong-Jin & Pae, 2001, 58.) “It is more appropriate to treat a good *guanxi* network as a necessary, but not sufficient, condition in China”, (Tsang, 1998, 71). *Guanxi* has also been shown to increase Return on Equity (ROE), financing and liquidity, performance efficiency, productivity as well as decrease the rate at which employees are replaced (Wong, 2010, 429).

Guanxi holds risks as well. The relationship may lose its value or even become a liability, for example when public figures, with whom the organization has good *guanxi*, become tainted by scandals. Another liability is that a person who holds good *guanxi* with an individual in an organization, suddenly asks for a very big favor. (Tsang, 1998, 70.)

The views whether or not guanxi can be treated as a strategic resource or a strategic source of competitive advantage differ. This may depend on the size of the company being examined. According to Tsang (1998), guanxi in most cases may not be treated as a source of strategic competitive advantage, since usually it does not meet the three conditions required: value, rarity and imperfectly imitable. This is especially true for large multinational corporations (MNC). The value of guanxi depends on how much more sales it creates and must be reflected on the time and resources spent in creating it. The value of guanxi also depends on the partner's status, which is not easily predicted years ahead. Still, it can easily be argued that guanxi brings value to a company. Rarity of guanxi can mean having good guanxi relationships to a selected few important individuals, for example to top-officials in a certain province or even Beijing. Such guanxi relationships are hard to come by and take years to cultivate, and thus can be interpreted as being rare. The difficulty in imitability is obvious, since it takes years to cultivate deep guanxi relationships, and even if one had such a time, personal chemistry would not necessarily enable this deep connection to happen. All in all, guanxi can be a strategic resource, but in most cases does not fulfill all the criteria of a strategic source of competitive advantage. It can however be argued that in most cases when operating in China, guanxi is a crucial source of competitive advantage. It must also be noted that guanxi is tied to a person. To lessen the risk and benefit the organization, measures need to be put in place so that individual guanxi is spread across an organization and guanxi must be addressed by company management. (Tsang, 1998, 67-70.)

Large multinational corporations of course downplay the importance of guanxi, but it has been found that for small and medium sized enterprises, a key factor for being successful is developing and maintaining effective guanxi relationships. Thus guanxi should be managed effectively by drawing guanxi maps, representing the resources each guanxi member has and the importance of the resources, so that the company knows towards which relationship to concentrate their efforts. Regular guanxi audits are recommended to rejuvenate the relationship and to evaluate the current resources the guanxi partner possesses. Guanxi strategy should be dynamic and should change along the business and the environment. (Su, Mitchell, Sirgy, 2007, 315-317.) Wilson and Brennan suggest that guanxi holds a strategic role in companies operating in China and that the strategic role of guanxi is still strong. However it is slowly diminishing. This is true especially for large MNCs, but for SMEs the strategic role of guanxi still remains. (Wilson & Brennan, 2009, 662.)

3.5 Chinese Business Environment

China is undoubtedly a major player in the world economy, which can be seen in the fact that it produces of 50% of the world's products (Lu 2009, 451). China however is not an easy place to do business in. Companies operating in China should focus much of their attention to the surrounding business environment, utilize their environment specific resources as well as to the relationships with the government (Zhou, Han, Wang 2013, 470). Institutional weakness is a problem when operating in China and something China needs to develop. Bribery, patronage, copyright infringements are common problems, for which China needs to respond by stronger rule of law from the public sector, and reduction of contractual violations from the private sector (Lane, 2013, 175).

A major problem with this is that the Chinese views on intellectual property rights are based on a long tradition of Neo-Confucian thought. In this line of thinking, it first needs to be understood, that ethics trumps laws. Changing the legal system or laws regarding intellectual property rights has little effect on daily behavior. Secondly it is worth noting that in traditional Chinese thought, intellectual property did not exist. The views on intellectual property are not found in laws or legal codes because it was considered profit from artistic production is low-class and immoral. (Lehman, 2006, 7-8.) Thus it is evident that legal system in China is in need of development with the focus of proper implementation in mind (Zhu, Camp, Garg 2005, 253).

One of the difficulties occurring when operating in China is the lack of Chinese negotiators acculturation, adaptation to other cultures. The ability to use a foreign language in negotiations is often lacking. This extends to the understanding of body language of foreigners, their values as well as their ways of thinking. Accepting Western culture of directness, meaning for example concentrating only on facts without involvement of emotions in negotiations, is often not accepted. (Jiang 2013, 111.) The combination of rather quick transition to a free market economy, together with lack of well-defined legal system, has led to a situation where business ethics of Chinese are not adequately developed and attitudes towards business ethics are consequence free and relaxed. Contractual based relationship management is seen as imposing control, i.e. in a negative light, and trust based relationship management should be preferred. (Al-Khatib, Vollmers, Liu 2007, 92-93.) Ownership-rights in China are somewhat troublesome. The laws regarding private property rights are not clear, and they are not especially transparent. There are situations where it is advantageous to disguise a company to look as if it was collectively-owned or even state-owned, when in reality the operation is run by a private person or a family. However the de facto situation is that the Chinese government respects private property rights and assures are given to encourage foreign investments in China. (Estrin & Prevezer 2011, 60.)

Chinese companies are developing a new method for creating new products called accelerated innovation, where the innovation process is broken into smaller steps, after which the steps are divided to teams for them to solve. Essentially Chinese companies have industrialized innovation processes. This ramps up the speed of the innovation process dramatically, although is unlikely to produce breakthrough innovations. (Williamson & Yin 2014, 27-28.) Companies who engage in partnerships with Chinese companies need to be wary of leakage and infringements of intellectual property when operating in China (Williamson & Yin 2014, 33) The key success factors in operating in China include effective management of guanxi relationship, experience of the Chinese business environment, awareness of the changes that are occurring in the business environment, as well as informal information exchange for gaining new critical information (Abramson & Ai 1999, 27).

When evaluating for a possible business location in China, one needs to evaluate first and foremost business forecasts, as well as future development of business, competitive advantage, building scheme and possible renting conditions. (Hsu 2010, 40.) The Chinese government has had a prominent impact on creating industrial clusters of various fields by investing heavily on infrastructure and through various governmental policies and investments. These industrial clusters attract multinational companies as well as local talent, which in turn increase the wages in those specific areas. (Weng & McElroy 2010, 260.) At a major area for production in China, the Pearl River Delta, the rising labor costs have become an issue. This means that retaining labor-intensive production there only for cost reasons is becoming unsustainable. Companies need to find other locations to produce if they want to keep their competitive edge derived from low cost labor, or alternatively find some other factors of competitive edge. Inland China provides only minor cost reductions, which means that other South East Asian countries are becoming more lucrative, provided that oil prices will not rise excessively. They however pose variety of other problems. (Huang, Zhang, Liu 2013, 683.) Trade operations located in Hong Kong are worthwhile due to favorable business environment and tax policies (Huang, Zhang, Liu 2013, 684). As a result of rising labor costs on coastal China and especially the Pearl River Delta, a manufacturing strategy titled “China plus one” has been gaining popularity, in which labor intensive parts of the production are performed either inland China or at low cost countries in Asia, such as Vietnam, and the final assembly of the product is done at Pearl River Delta or coastal China region in order to reap the benefits of both low cost labor as well as industrial clusters and their efficiency. (Zhang & Huang 2012, 147.)

The problems with the distribution systems in China are the lack of developed physical infrastructure, state-owned distribution companies unable to provide high level service, uneven economic development from area to area, large but fragmented logistics sector as well as regional protectionism (Jiang & Prater 2002, 796-797).

Despite China lacking formal institutions powerful enough to enforce the written laws and regulations, the informal institutions have developed to substitute this gap. The goals of formal and informal institutions are compatible and strive to achieve similar things. (Estrin & Prevezer 2011, 61.)

4 METHODOLOGY

For this thesis a literature review was conducted of the relevant literature of the main topics of the research regarding contingency theory, supply chain resources and capabilities, adaptation and the Chinese institutional environment. From the basis of literature review a theoretical model was created. In the theoretical model supply chain resources were taken from Grants (1991) research, capabilities were constructed from numerous sources, institutions from Khanna, Palepu and Sinha (2005) and adaptation from Größler, Grübner and Milling (2006). The aim of the literature review was to depict workings of a supply chain in a broad holistic way in order to understand how the institutional environment affects supply chains of Finnish focal companies in China and how those workings are adapted in order to find a better strategic fit with the surrounding institutional environment in order to form a supply chain that subsequently fits with the surrounding institutional environment.

Case study method was selected as the appropriate method of researching the topic at hand as it focuses on “how” and “why” questions in trying to explain the research questions, as well as the fact that it suits well for researching contemporary events. This coincided with the fact that researcher has no control over the subject phenomenon, case study has a distinct advantage. (Yin, 2014, 9, 14.)

Multiple-case design was selected, as multiple perspectives on the same topic could reveal more insight than just a single-case design. The aim was to achieve a more compelling and robust research in terms of results and generalizability. (Yin, 2014, 57.) Multiple cases can also augment the external validity of the research, as well as assist in preventing misjudging of a single event or even exaggerating easily available data, even though less depth is reached within the given resources (Voss, Tsikriktsis, Frohlich, 2002, 203). Three smaller focal companies were selected in order to view the Chinese institutional environment and the adaptation process taking place from the perspective of a smaller focal companies. Large focal companies were selected to contrast the results achieved from smaller companies, in case there are differences between how large and small focal companies perceive the relative importance of resources, capabilities and adaptation within the institutional environment.

4.1 Case Selection

Case selection and sampling is especially important in multiple-case studies (Voss, Tsikriktsis, Frohlich, 2002, 202). The aim was to restrict extraneous variations and to sharpen the generalizability of the results through focused case selection (Eisenhardt,

1989, 533). In addition purposeful sampling was utilized as the aim was to find information-rich cases for a more in-depth examination of the phenomena (Patton, 1990, 169, 182). In this thesis a decision was also made to utilize multiple cases to give a broader understanding over the phenomena. As a result the aim in case selection was to find multiple companies that could provide the most insight into the phenomena under research.

The parameters upon which focal companies were selected were as follows. Focal company size is an interesting factor, as larger companies could field more resources to achieve their goals. As a result the goal in case selection was to find both large and small focal companies to research. As this thesis concentrates on the supply chain management in China, focal companies needed to have both upstream and downstream parties in China. Additionally a decision was made, that in order to ensure that the focal companies had a complete understanding of what it means to operate in China, one of the criteria of searching focal companies was that they needed to engage in manufacturing in China. This was also a criteria so that all focal companies would have enough similarities to make comparisons, as well as to grasp the facet of the institutional environment of producing products in China. The best way to achieve this in case selection was to target companies that engaged in manufacturing and selling in China.

Companies were searched based on if they did business in China and sold to Chinese customers. The reason for this was to be able to analyze companies that witness the business environment completely both as a buyer and as a seller, as companies merely sourcing from China do not necessarily experience the full spectrum and all the nuances of the Chinese business environment. This also enabled examining the supply chain management activities companies engaged in China. Further selection was done based on if the companies engaged in manufacturing in China. The goal was to find both large multinational companies to be interviewed, as well as smaller companies in order to compare if there are differences between perceived priorities between resources and capabilities, if the institutional environment was different from the perspective of large and small focal companies, and if the adaptation process was different based on company size. Companies that matched the parameters above were contacted for an interview.

Out of all the companies that were contacted, six agreed to interviews. Of the six companies, three were large multinational corporations and three were small Finnish enterprises. Names of the companies as well as the identities of the managers interviewed were agreed to be kept confidential. This was due to the fact that the interviewer did not want the interviewees to inhibit their statements about the possible negative aspects regarding the Chinese business environment, as it could potentially danger their further business prospects and prevent finding out the actual nature of things when doing business in China. Companies were assigned designations of companies A, B and C, comprising of small companies and D, E and F comprising of large companies. The large companies consist of Finnish MNCs, whilst the small companies employ less than 100 people in

China. It is important to mention that the small companies in their entirety do not fit into the European Union classification of small and medium sized enterprises, as they either employ over 250 people worldwide, have a turnover of over €50 million or have a balance sheet total of over €43 million. However for the purposes of this thesis they are referred to as small companies in order to separate them from the large companies, as they clearly are of different scale than the large MNCs.

4.2 Instrument Development

Interviews were chosen as the preferred method of obtaining data, as they are targeted towards the topic of the research, as well as being insightful in providing explanations and personal views (Yin, 2014, 106). Both were important, as the other means of gathering data could be less efficient and effective. Insightfulness was also deemed important, as the perceptions and interactions between Finnish and Chinese managers are important in understanding the cultural differences, which according to the literature review could be a significant factor in doing business in China. An interview guideline was developed to capture the facets of supply chain management of Finnish companies and the institutional environment in China based on the literature review. The interview guideline entailed questions regarding the resources and capabilities of the supply chain management of Finnish companies operating in China, the adaptation of resources and capabilities as well as the institutional environment, based on the theoretical model constructed for this thesis. The questions in the interview guideline were open ended, as the interviews were kept rather conversational. Additional specifying questions were asked if needed. The interview guideline is found in the appendix 2 of this thesis.

4.3 Data Collection

Interviews were conducted with companies that agreed to be interviewed between March and April of 2015. The interviews lasted between 30 minutes and 90 minutes. Most interviews were conducted within the premises of the organizations, but two interviews were conducted over the telephone, due to difficulties in arranging a face to face interview because of time and distance constraints. The interview questionnaire were sent to the managers as the interviews were arranged so they would have sufficient time to familiarize with the questions. The interviews that were conducted on the company premises were recorded and during all interviews extensive notes were taken. The questionnaire framework was used as a guiding principle throughout the interviews but in a flexible manner, meaning that the exact topics of the discussion could also diverge from the original topic.

4.4 Data Analysis

The recorded data was transcribed and arranged thematically into sections of institutional environment, resources, capabilities and adaptation, and then analyzed. The results are presented in chapter 5 of this thesis, including the analysis regarding the most important institutional factors affecting Finnish companies. A further analysis was conducted regarding how these institutional factors affected resources and capabilities of Finnish companies supply chain management in China. Interview data was codified and connections between different factors were made, as the data supported this. The codification of the data can be found in the appendix 1 of this thesis. Consequently the data connected to a particular institutional factor was grouped together and charts regarding the amounts of connections between the resources and capabilities affected were created. This revealed strong relationships between certain institutional factors with certain resources and certain capabilities. These relationships were further illustrated with logic models showing how exactly the institutional factors affected the resources and capabilities of companies. This is presented in the analysis of this thesis.

Adaptation of companies was analyzed in a similar fashion, first by thematically arranging adaptation into groups presented in chapter 5, coding and gathering the codified data together, identifying the most relevant forms of adaptation and describing them in a logic model. Two main forms of adaptation were found to exist. An additional analysis was also made identifying the critical resources and capabilities to supply chains' success by listing the mentions or insinuations of critical resources and capabilities. The reasoning for analyzing the data in multiple different ways was to allow multiple different perspectives to investigate the data, and ensure the conclusions were sound, accurate, and reliable (Eisenhardt, 1989, 541).

Later the interview data is analyzed and mirrored with the literature review, which is presented in chapter 6. Mirroring the interview data with the literature review revealed some additional factors, and are presented in the discussion. This chapter also discusses the points made by the literature review, and whether or not the interviews supported these views or not.

4.5 Reliability and Validity

The evaluation of reliability and validity is based on Yin's (2014) four tests of judging the quality of research design, which are construct validity, internal validity, external validity and reliability (Yin, 2014, 45). A further analysis of the generalizability is discussed in depth later with the conclusions.

Construct validity, meaning establishing the correct operational measures for the study of the given topic, were established through presenting a chain of evidence. This refers to the fact that the reader is presented with the relevant interview data, as well as the coding of the data found in the appendix of this thesis. Thus the reader has the ability to follow the construct of the research questions, the formulation of the theoretical model, the formulation of the interview questions, as well as access to all the relevant data obtained through the interviews, including the coded data found in the appendix of this thesis. The conclusions are drawn from the literature review as well as the interview data, meaning that the reader has the ability to trace the chain of evidence leading to the conclusions of this thesis. A total of six companies were interviewed in order to get a comprehensive view over the Chinese institutional environment, not swung by the views of a single company in a single field of manufacturing. (Yin, 2014, 127.) Naturally the construct validity is hindered by the fact that the companies, as well as the identities of the managers being interviewed is kept confidential and the full interview transcripts are not provided as they would be lengthy, in Finnish, as well as might reveal critical information that could reveal the identities of the parties involved in the interviews. The relevant issues however are covered and presented.

In regard to the internal validity, or the validity regarding the establishment of causal relationships, whereby certain elements have a causal relationship on other elements or conditions (Yin, 2014, 47), special care has been taken to ensure that the causal relationships are firstly supported by the literature review, and only after that examined. The causal links that have risen from the data have been carefully examined, and pattern matching has been implemented in order to examine the data from the perspective of previous research. This is evident in mirroring the research data with the literature review and previous research in order to make sure that conclusions are based on either previous research or very strong evidence from the data. In order to ensure internal validity, careful measures have been taken to present the steps taken for any conclusions to be made so that the reader can follow the process of arriving to these conclusions. Logic models were also created to illustrate the relationships between institutions, resources and capabilities and explain the causal relationships between them, in order to give a clear understanding how the various aspects of the Chinese institutional environment affect supply chains operating in China. (Yin, 2014, 143.) Potential hindrances of internal validity however do exist. This is evident in the case of researching Chinese business culture, as interviewing the Chinese business partners would have helped to confirm or disconfirm some of the conclusions made by this thesis. Also more could have been done in addressing more rival patterns by examining the data from the perspective of some other theoretical models.

External validity, or the question if the conclusions of this thesis are generalizable beyond the immediate study (Yin, 2014, 48) should also be examined. The reliance on

previous research, as well as utilizing multiple interviews should increase the external validity and generalizability of this thesis. Also case selection affects the generalizability of a study (Eisenhardt, 1989, 534). It must however be concluded that due to the nature of this research, the generalizability of this thesis is relatively low, as the intent has been to understand the underlying phenomena. With deeper understanding of the phenomena, further research could be designed to reach generalizable results.

Regarding reliability, careful measures have been taken to ensure that the thesis and its conclusions are repeatable by other researchers. This has been ensured by relying heavily on previous research, presenting the research process to the reader, and basing the conclusions on sufficient amounts of data presented to the reader.

5 ANALYSIS AND RESULTS

In this chapter the interview data is presented in a thematically arranged format. The first section dwells on the business environment in China and forms its own section. The next section presents the resources, capabilities and adaptation and the analysis.

This chapter consists of interview data that is directly derived from the interviews. As such the writer has added very little commentary and the interview data presented here is very much unadulterated, with the exception of removing some issues that could help identify the informants. Because of this the tone of this chapter is at times rather declaratory. The aim of this chapter is not to present issues regarding supply chain management in China as they are, but as they are presented by the informants. As such, strong statements in this chapter should be interpreted, not as absolute fact, but as views of the informants.

5.1 Institutional Environment

According to the interviews, the atmosphere regarding the institutional environment in China is very positive. The Chinese economy is clearly growing, and as a result many things are occurring. Based on the interviews, there are many differences to doing business in China, compared to elsewhere, but one key factor stood out, which is the speed of things that are occurring in the business environment. With regards to the institutional environment in China, the rapid growth poses a whole new dynamic to doing business. In order to succeed in China, companies need to be fast at making decisions due to the fast pace of changes happening in the surrounding environment. Also managers need to know what is going on in the business environment. As one manager put it “you need to have done your homework”. This all places much emphasis on the human resources and organizational resources of the company. “Run faster than your competitors” was a guideline given by one manager, regarding the success factors when doing business in China. An important perspective to the speed of the business environment is that if you order a test batch from a supplier and he doesn’t hear from you for three months, they will forget you. Speed is an advantage. One thing that the Chinese find extremely annoying, when it comes to their Western counterparts, is the slow speed at which Westerners do things. “It is a daily struggle with the Chinese that Western managers are unable to make decisions”, as one manager expressed it.

The speed of doing business, in addition to being very fast, can also be very sporadic. Things can lag for a very long period of time, nothing is happening, and just when you are about to lose all hope, all work is completed in one night. As company F manager put it, “China is a project manager’s nightmare”. You must also expect the unexpected. In

China one must not get confused when things do not go as planned, or go even completely against what was planned. Company E manager gave a casual example of this when he was at a meeting and was asked if he wanted to drink coffee or tea. After stating coffee was his preferred choice, he was asked if he wanted milk or sugar in his coffee. He replied both would be good. Soon, he was brought a cup of tea and told it was much better for him than coffee.

At the moment, China has lost a large part of its competitiveness to foreign markets due to the strengthening of the local currency Renminbi (RMB). In the last ten years the currency has doubled its value. One manager even speculated that China will soon devalue their currency to counter the rise in value of the currency. At the time of writing this thesis, this prediction came true.

5.1.1 Political and Social System

The Chinese political system differs from its Western counterparts, mainly in that it is not a democracy. It is a single party system with the Chinese Communist party in rule. Company F manager was describing the political system in China that is of its own kind, and has to be respected and understood. It is what it is, and has to be worked with. As a system, the Chinese political environment is very consistent and is considered very safe. Of course the regulations change and there are different periods that China is going through, but mostly the political environment is very stable. Company D manager was saying that the Chinese political system is very different than that of in the West. He explained that there has always been a strong leader in China, so it would be hard to imagine China as a Western democracy. The communist party wants good things for their people due to the fact that they studied the reasons for the fall of the Soviet Union. The communist party understands that they need to keep the middle class happy. Slightly diverging views were also expressed. For example another manager said that the main aim of the political system in China is to keep the Communist Party in rule. These days the actual policies implemented are not of a concern, but rather providing services to the members of the party. Communism and socialism are not of a concern, as capitalism is the way to go. Stability and at times instability was also of concern to some of the managers. Company E manager was describing that the political system in China is relatively consistent. There is a five year plan that sets the direction in which things are moving, and what the priorities of the country will be. The problems start to arise when the local governments are not necessarily in line with the state government and have their own conflicting priorities. Problems also arise from the fast pace of things happening in China, because in a very short period of time situations may change, which naturally has an effect on the aspirations of local politicians. For example the rapid expansion of cities can easily

render building permits useless, which makes the possibility of capacity expansion very uncertain. Surprises and uncertainty are major factors in operating in China.

On the notion of people involved with politics, company D manager explained that the difference between the Chinese and Western political systems. He said that the smartest people who graduate from top schools see politics as their first choice, and finance as their second preference, whereas in the West it is the other way around. As a result, the manager had a strong belief in the Chinese political system, saying that “if there is a government that can handle problems, it is the Chinese political leadership”.

Another theme that rose from the interviews was the anti-corruption campaigns of the Chinese governments. As company F manager put it, nowadays regulation-wise China has become a very strict society in a very short period of time. This is due to the anti-corruption campaigns the Chinese government has set up, and are not restricted to only corruption. The campaigns extend to all forms of regulations, and every single issue is done exactly by the book. The momentum has reached the opposite of what it was a few years ago, and people are very weary of doing anything at all that could be considered anything else than strictly legal activities. This is slowing the business environment down. Previously, it was much more flexible without anything being even close to corruption, but now China has entered very strict “by the book” type of control. As everything is done according to this mentality, no anomalies are prohibited. The situation has been afloat for about a year now and will likely to continue. Company B manager explained that the strict control by the governmental authorities and the political system poses some restrictions and prevent companies from going solo on some issues. The anti-corruption campaigns have posed restrictions on many fields of governance, especially in forms of enforcement of regulations.

Company E manager was voicing his concerns regarding the complexity of working with the Chinese authorities. Procedures might change from week to week, so any supposition of actions taking place might be wrong. One needs to be prepared to change procedures often. This is why official business is not necessarily consistent and in general is very unpredictable. Opposing views rose as well, as company C manager was saying that operating in China is not dramatically different from anywhere else. Companies have to prove that their solutions make sense. Bureaucracy-wise China is of course is comparatively more complicated, although not to the extent it is in Russia. When it comes to the institutions, the Chinese authorities are very service minded. Cities compete on potential Western companies establishing their business there. Company E manager said that “the business environment is in general not restrictive”. Regardless of where you work, you need to adjust to the environment. The problem is not the customers or the local population but, Europeans who don’t understand what it’s like in China”. What this refers to is the problem of explaining in depth all the subtleties of the institutional environment and

how it affects the way of supply chain management to a person who does not understand the place.

The notion of environmental protection rose as well, with company F manager explaining that environmental regulations are very strict in China, possibly even more strict than in the Nordic countries. For new companies, getting environmental permits is very difficult. With regards to pollution and the environment, government regulations pose of course many possibilities for Western companies, for example in clean tech.

Contracts were also managed differently in China than they are in Western countries. Company E manager condensed the issue of contracts by saying that “they are generally abided by and thus contracts do have significance. Whether or not it is always needed to write a paper is another matter.” Company A manager said that when it comes to making contracts, “the Chinese don’t pay much attention to the actual written contracts. Trust is more important than the written contract”. As the manager put it “contracts are just paper”. The main concern when making contracts is the product and down payments. As a result the written contracts are very simple, and mainly state the terms of payment, which usually progress as the work progresses.

What makes the Chinese political and social system at times hard though, is the properties of the Chinese language. This extends to contracts as well. When contracts and regulations are written in Chinese, due to the potential vagueness and multiple potential interpretations of a single sentence, official texts can be interpreted in multiple ways. This has a potential of causing problems.

The weak reinforcement of contract is generally a sign of weak judicial system. In China, it is possible to take another company or individual to court, but generally all lower level judges can be influenced with bribes. As a result, if a Western company wants to go to court, they have to take the case to higher levels where judges are more impartial. All this takes a lot of money and a very long time, and as a result many companies avoid going to court.

A real problem with the institutional environment however, is the information technology infrastructure and slow IT connections. For those reasons, many Western companies establish their base of operations in Hong Kong or Singapore. Censorship is also something that affects Western companies and their supply chain management activities.

The social system in China is completely different than in Western countries, which can be seen in the way of thinking. In the West, people are used to very structured way of making decisions and thinking. The Chinese way of making decisions is very intuitive, as well as not very structured. This however is not necessarily a bad way, for it can easily yield very good decisions. In China, as company F manager put it, “I have learned that there is no single right answer. You can do things many different ways and we need to learn to look at things from many different perspectives.”

Company D manager further extrapolated this by explaining that culturally the Chinese are different than Westerners, and in general different than Finns. In Finland the underlying assumption is that as long as you have your facts in order and you are doing good analysis, you are in the clear. In China however, you need both heart and analysis together. The manager provided an example of a situation where he had prepared very well for a presentation and made sure his facts and figures are in order, so he could base his suggestions for future actions on facts. The Chinese audience however questioned the presentation, asking who had validated the data. Numbers and data was not enough, they needed an authorization from a higher manager, before people could go forward with the plan presented. This comes to show two things: that the Chinese culture is authoritarian, and that numbers can be discarded in favor of a feeling or an emotional reason. He also explained that in China, it is important to openly show your support for your superiors. In return the superiors will support you.

Company F manager explained the differences between Western and Chinese social systems a bit differently by saying that the social system in China is very different than in the West. Every day one encounters surprises, and not a single day is boring. One has to find his or her own place in the society and adjust to the surrounding system. Of course one has to find the middle ground where both parties find a win-win situation. They do not like if one party tries to take it all, and as a result you can only double cross them once, after which you are out. Company D manager explained that when doing business with the Chinese, you must always ask yourself why a person is talking in a certain way. It can lead to cynicism, but people tend to have a selfish motive to act in a certain way. A good question to ask is “where the money is going and who is making money and how?” This will often clarify many situations. As a balancing force between playing games and the pursuit of money, the concept of face exists to provide the Chinese with longevity in doing business. The concept of face establishes that people have something to lose.

Another cultural factor that affects business in China is that it is very hard to get a straight answer, as company F manager explained. Often to a question regarding if action X will be completed or not you will not get an answer. It is commonplace to receive an answer, such as: “we will do our best”, rather than receiving an exact date. This also relates to quality thinking, because the Chinese are very good at avoiding discussing problems and acknowledging problems. In the Nordic countries people are used to pointing out problems and solving them together, whereas in China they rather use 20 hours hiding a problem than one hour to correct it. If you bring up a problem, even as a messenger, you are punished. This of course is an exaggeration but is somewhat descriptive of the culture. They are not used to openly bringing problems to frame.

According to company A manager, corruption is something that happens in China, but that Westerners should not get involved or partake in it. “In very few cases bribes are requested, and if turned down might slow down some things, but are not a necessity that

Westerners should engage into”, was how the manager described such illegal activities. Levels of corruption also depend on the area, on the coastline of China it isn't as commonplace as inland China.

As a conclusion, managers perceived the political system in China to generally speaking be safe, consistent, and mostly very stable. However, the anti-corruption laws and regulations that have been implemented over the last few years have had a significant effect on businesses. At the same time, the local governments exercise their own discretion on certain issues. Therefore when Western companies and their supply chains are doing business in China, it is important to acknowledge that both local government public actors as well as national level public actors have an effect on businesses. At times when it comes to local governments, regulations can change rather quickly. Environmental regulations especially are very stiff, which might pose problems, as well as opportunities for companies.

Although the political system in China is relatively strong, weak judicial system can cause problems. This holds especially true in lower courts that could potentially be bribed, but when moving to higher courts the problem should diminish. Corruption exists, but many managers said that Westerners should not take part in such unlawful activities. To counter corruption, the Chinese government has issued vast anti-corruption campaigns. These campaign have a direct effect on doing business by reducing flexibility and in some cases by slowing down the speed of doing business. As company F manager put it: “the momentum has reached the opposite of what it was a few years ago, and people are very weary of doing anything at all that could be considered anything else than strictly legal activities.”

5.1.2 Capital and Financial Markets

Capital and financial markets are very developed and they work very well for both individuals and for companies. According to company A manager however, the local small and medium size enterprises face a hardship of gaining capital from the capital markets. This does not concern Western companies, which are able to get all the capital they need from the Chinese financial markets. As company A manager further explained, an interesting particularity of the Chinese markets is the dual currency system that is employed by the companies operating there. In addition to RMB used as a currency, a major part of transactions is paid with bank acceptance notes. Usually they expire in six months, at which point the party controlling the note can claim the sum from a bank. These notes are commonly used as currency and a method of payment in B2B transactions. If a company wished to claim the money before the expiration date, there will be a fee of over 10%.

The economic system in China is not exactly clear and many seemingly strange things are happening. Examples of this are the shadow banking system which was repeatedly mentioned in many of the interviews, but not further extrapolated.

Company A manager was also wondering, how it is possible for “many Chinese companies to be in the stock exchange, at the same time to be family owned and run businesses, in addition to being public government owned companies.”

5.1.3 *Openness*

The majority of managers interviewed felt that the Chinese markets are very open to foreigners. Development zones do everything in their power to help foreign companies to succeed. Company D manager said that the openness in China is on a very high level. The people are able to unlearn unnecessary patterns, and really want to learn new things from the West. People are very entrepreneurial in their attitudes and everything that can make money is seen as good. The government has a hand on regulations, but to an understandable extent. They see that Western ideas are good and beneficial.

Company E manager was phrasing the same thing by saying that the Chinese are not very conservative in their thinking and as a result are very open to new ideas regardless of the country of origin of the idea. As long as the new idea or thing is of use and utility to them, they are willing to change their behavior. With government officials, openness is high as long as one can provide arguments of how the Western product or idea will benefit China and its people. When the proposition presented benefits the Chinese themselves, they are very open to new thoughts. Company F manager concluded this issue by saying that “the Chinese are very curious and interested in new ideas from the West.”

5.1.4 *Product Markets*

Based on the interviews, the Chinese product markets, both upward and downward from the interviewed focal companies, are very different from their Western counterparts. The main differences include the size of the market, as well as the mentality differences in quality and service components of business. The difference in the speed of the business cycle was also mentioned.

Regarding product markets, information about customers, imports and other data is available, however the reliability of that information is, is rather questionable. According to company E manager, there are more things happening in China in a quarter than in Europe in a year. As a result the data used for an analysis tends to be outdated.

Company A manager pointed out that the size of the Chinese markets is huge so it is important to find a niche where a company is able to do its own thing. A small company is virtually unknown and needs to work very hard to find its own place in such a huge market. When working on a narrow sector, it is relatively easier.

The difficulties with supply chain management in China were pointed out by company B manager by saying that the pace of doing business is seen as both upward and downward movement in order volumes. The combined effects of development speed of the Chinese markets, and bullwhip effect have driven many Western companies out of China because they have been unable to respond to the quick changes in the markets. The manager concluded that companies that come to the Chinese markets to manufacture cheap goods, in order to sell them to other markets, have been disappointed and have had to move away from China. Also companies that have jumped on the bandwagon to come to China because it is trendy or because their aim has been to make quick profits have not been successful. As company B manager put it, "China is not a cheap market, and it is definitely not an easy market. Manufacturing and then exporting from China has not been a beneficial strategy in a long time." One manager identified the companies that function the best to sell to the Chinese markets, or to the surrounding nearby markets.

When it comes to managing bigger projects, the biggest differences between Western countries and China, when it comes to doing business, are the fact that Intellectual Property rights need to be taken seriously, as explained by company A manager. The Chinese are notorious for copying things, and as the most visible result, projects are managed completely differently. In Europe companies generally try to search for system suppliers who can provide the entire system from start to finish. "In China on the other hand it is commonplace to divide the system into smaller parts and to multiple suppliers. That way none of the suppliers have a clue what the entire finished system will look like. It is done in order to prevent them from copying the system."

Based on the interviews, differences in sales also became apparent. Company D manager described the style of sales in China as different to that in Europe, due to the fact that in China customers are used to being sold to through the traditional method of presenting the customer with the features of the products and trying to sell the product through its technical qualities. In Europe the style of selling is more concentrated on solving an entire problem through solution selling. Company E manager elaborated on the topic of sales a bit differently by saying that the difference in sales between China and the West is that the Chinese buyers are not particularly interested in the long term benefits. Although they are interested in the benefits of the products and how they can gain from buying from a particular seller, arguments about life cycle costs are however not really effective. The problem with products of very high quality is that the customer might not understand their long term benefits compared to lesser quality goods, and as a result would not buy the better quality product. This difference in mentality probably comes from the urge to

“make millions in a moment”. As the manager in question put it, “when you are not sure if the world even exists tomorrow, you need to do a lot today”.

Selling services in China was perceived to be rather tricky, because the concept of service does not exist as such. The mental framework is such that if you buy quality, you don't need to maintain or service it. That is why it is hard to sell service component to a Chinese customer. This however is changing, as in some of the coastal Tier 1 cities, selling a product without a maintenance reference is starting to be difficult. Changing the market is slow and hard, but still possible if you have the common direction and the help of competitors.

In the product markets, there are many Chinese-Western joint ventures. The reason for this arrangement is due to the fact that Western companies have had a hard time understanding the Chinese culture, and Chinese companies have had a hard time figuring out Western technology. By combining the two, much progress has been made and the result has been very professional companies that fit the Chinese market very well.

According to the managers interviewed, the concept of quality seems to be somewhat different in China. In Western companies the mentality is that quality has to be consistent, but often in China after presenting high quality sample products, the quality of the products might decline shortly after. The products might be made of different materials or even at a different place, disregarding the original product specifications.

In some industries, the product markets in China are still in their infancy and being developed. According to company C manager, the Chinese market differs in a sense that the Chinese within the very specific industry the managers company operates in, want to establish their own industry standards apart from standards used elsewhere. This has led to a situation where the standards are still being developed, and no one has a clear view what the industry standards will look like in the future. Many local standards exist, which makes the industry even more chaotic.

In addition, electronic trade has also been identified to be growing enormously in China. Especially in consumer goods, customers find it very natural to buy products online, and the trend is growing.

5.1.5 Labor Markets

When it comes to labor markets, most managers agree on a few key issues, being that the Chinese labor markets are huge, finding skilled workers is at times difficult, and high employee turnovers may cause problems. As company D manager put it: “the labor markets in general pose a major challenge for Western companies operating in China. This especially, because successful management of labor markets in China is a critical success

factor.” Company A manager added that the labor markets in China are vast but undeveloped. Finding skilled employees is hard and generally companies have to train all of their employees. Commitment to an employer is low, and as a result 25% of employees can quit in one year. This leads to even greater need to train new employees. Retaining workers can be done through competitive salary and by a promise of a lucrative career path. The Chinese employees appreciate their education but expect raises as a result of training. Salary based on incentives is very commonplace. Company F manager told that since China has an enormous population, there are all sorts of employees available, but the hard part is finding the right employees and retaining them. This is true on all levels. Salary inflation is quite high, and wages will rise close to 10% annual rate. This combined with the high turnover rate makes managing human resources and talent very demanding.

As a result of a large employee turnover, companies need to train vast amounts of new employees. Company A manager shared that the solution to this is writing Standard Operating Procedures (SOPs) for every position. “The Nordics are known to be bad at this, due to the culture of hands-off leadership, giving responsibility to employees, and working in teams that are collectively responsible for their actions”. The Japanese on the other hand have been very successful at describing each task and each position in the company. Writing detailed SOPs will however lead to additional risks, because when they are taken outside the company facilities, they can be copied and used by competitors, which according to one manager is very commonplace.

Company D manager described the situation by saying that the major problem in China is finding blue collar managers to lead the workforce, because often the locals don’t want their sons to go into certain industries, for example construction. This is because they don’t see career opportunities in construction, meaning that once you are a construction worker, you will always be a construction worker.

Another problem related to the labor markets according to company A manager is that the innovation capability in China being weak, due to their education system and leadership culture. Mistakes are frowned upon both in school and at work, which does not encourage people to take risks. If an employee fails at a task, the mistake is taken off of his or her salary and a picture of him is posted on the wall.

Recruiting top management divided opinions, as company D manager said that recruiting top management is relatively easy. People who have studied in top Western universities and who have the necessary qualifications are not difficult to find, but generally they do know their own value and are not cheap. Company B manager on the other hand told that recruiting managers that are well trained, experienced, know languages and are adept in using information technology is very hard. Sometimes even after signing contracts people might not show up because they have already changed employer.

On a more positive notion the legislation regarding labor markets is less stiff, than in Finland, according to company F manager. In addition many Chinese dream of founding

their own company and becoming entrepreneurs. The attitudes towards entrepreneurship differ vastly compared to Finland, and are much more positive.

5.2 Resources

5.2.1 Financial Resources

Regarding the significance of financial resources, views between small focal company managers were divided. Company B manager explained that obtaining finance in China is very different, than it is in Western countries, and is seen as a difficulty by company B. There are many regulations that affect the process of obtaining capital. Bureaucracy, taxation regarding VAT, labor taxation and obtaining permits have been identified as difficulties Western companies face when working in China. Learning the business environment takes time and as a result it may take years before business in China becomes profitable. On the other hand company C manager explained that finance is generally something Western companies can take care by themselves. There are multiple different instruments, for example loans from different lenders, including Finnfund. As long as companies have good ideas, references and a stable business, finance shouldn't be a problem. Large companies did not have major issues with financial resources in China.

5.2.2 Physical Resources

All three small companies had manufacturing facilities in China. Based on the interviews it seems that physical resources matter in a sense that they need to exist. Without a manufacturing site in China operations would not be possible, but when it comes to the quality of the machinery and other related factors, physical resources don't matter as such. This also includes warehousing facilities. As one manager put it, "If you are going to sell in China, you have to produce it in China. It is ridiculous to freight goods from Europe considering the delivery times and costs." Having a manufacturing facility in China is of course important. Producing goods in China is very easy.

All three large focal companies have manufacturing sites in China. Company D has a factory in China, from which they deliver products to their Chinese customers. Components come from suppliers in China, both European and Chinese companies. Some specialty components are brought from Europe. Company E has a production facility in China. Most of company E's products sold in China are produced in China, but around

20% of the products, mainly the specialized very high quality products, are imported from Europe.

For company F physical resources include production facilities in China, which are very good in their case. Only company E is not completely content with the production facility. Company E manager explains that physical resources have not played a major role, since the manufacturing site in China has not completely met with the expectations. A major concern with the physical resources is of course capacity utilization, but other than that, physical resources are not seen as a critical resource.

Overall physical resources tend to matter in the sense that they need to exist in China. Only company F had very good manufacturing facilities in China, and especially large companies imported a portion of their products to China from Western countries. This mainly includes products of higher quality and very specialized items.

5.2.3 Human Resources

Overall with smaller companies, all managers agreed that human resources were very important. Company A manager explained that human resources are very important when doing any business, and in China they are particularly critical. In addition to local staff, all companies should place a “watchdog” to the Chinese unit to make sure everything goes as planned. A rather large Finnish company made the mistake of letting their Chinese counterparts to manage the Chinese unit alone without such a watchdog, and as a result between 25 million and 40 million RMB were stolen.

Human resources that company B employs include a workforce of low skilled labor and a management team, which includes a Finnish manager. Many of the managers, despite having a university degree, don't necessarily have previous work experience, nor experience in working within a Western company. Thus many of the managers have grown with company B. Differences in culture and especially in leadership culture exist between the Chinese and Finnish managers. The Nordic model of leadership, which involves empowering teams and giving them responsibility to complete tasks, is hard to establish in China. Although company B has seen good results in training people in accordance to the Nordic approach, it was especially successful amongst people who have been working for company B for a longer period of time. This has also been a contributing factor to retaining employees, and as a result employee turnover rates have been low compared to other companies. Analysis of the human resources and discussions have revealed that since salaries company B offers are quite normal, the corporate culture has been a very important factor in reducing the turnover rates. Company success, leadership

style, and people seeing the results of their work have also contributed to retaining employees.

A matter that both company B and company C managers agreed on was the technology transfer through human resources. With company B the major challenge with technological resources and their transfer is the human resources. The reason for this is that the Chinese employees lack a deeper understanding of technical blueprints. Often the blueprints company B receives from its customers are faulty in some way or another, and it requires certain skill from employees to understand where the error has occurred and then to correct it. Previously these blueprints have been used in the home country to produce products, but the home country employees have been able to make adjustments so that the end product is up to standards and works. Unfortunately this knowledge is often silent, and doesn't transfer with the technical blueprints. As a result there is a need for the Chinese employees to spot these errors. Documentation helps, but often it is in the wrong language. Translations are needed in most cases, since the majority of the workforce does not speak English or Finnish. The Finnish companies are at fault regarding this as well, because documentation is notoriously overlooked in Finnish companies, and often products are produced with a general idea in mind using employee ability to solve problems. Outsourcing without proper documentation has not been very successful.

One of the problems that arise when using technology and information systems, is that many of the systems are in English, which makes it difficult for employees who don't speak English to use them. Instructions need to be in Chinese and translators need to be utilized. Also, the mentality of following orders exactly when it comes to information systems is often lacking. For example in warehouse, recording to the ERP system the taking of components, or even taking components from the right stock is lacking, which causes significant problems in inventory management.

As company C manager put it, "one cannot downplay the role of European technical experts that are located in China". Expatriates are important and it is critical that they live in China. Western experts bring capabilities to the company, especially from the perspective of the customer. This holds especially true when it comes to technical competencies. Also, when it comes to the competencies of the human resources, employees need to have hands on experience on the field they work in. "It is pointless to imagine that you would learn anything from reading a book. You cannot take people into training and think it is enough, they need to learn through working".

For larger companies, human resources are very important as well. For company D the most important resources are human resources paired together with organizational resources. A major challenge of Western companies in China is the language barrier. Compared to other places where most people speak English, China is the exception. That creates a dilemma of how to transfer competence that exists elsewhere within the company to the company segments in China. Culture, according to the manager from company D,

is even more important than the language. The problem with this is that even though it takes a very long time for a Westerner to learn the Chinese language, learning the culture is close to impossible. In addition to the difficulties and time requirements of training Westerners in Chinese ways, the amount of people needed exceeds any potential amount that can be trained. As a result, many companies have opted to train Chinese locals, because it takes much shorter period of time.

For company F, when it comes to resources, the three important factors are accomplished top management, accomplished middle management, and accomplished workers. This does not differ from that in Europe. It is however important to understand the local working culture and the pros and cons of that culture. You have to be able to work in accordance to the local culture, and at the same time to bring expatriate knowledge to the table. When it comes to the Chinese business culture, differences between Chinese and Western business culture exist in some areas. For example concepts such as quality, and thinking holistically, are something the Chinese are not as good as their Western counterparts. In China, things are viewed in shorter cycles, which is not to say it is better or worse, it is just different. This is especially seen in attitudes towards quality, as the big picture thinking is lagging behind Western countries. This leads to the Chinese being eager to save money today, even though it will cost them manifold tomorrow.

In the Nordic countries everyone, on every level of an organization, is used to the kind of thinking that when you give an employee an assignment, in a week they will come back with the output that you have asked for. In China it doesn't work that way, and responsibility is with the manager. The leader is responsible for the completion of the task and has to micromanage whether the employee has understood the assignment, started it etc. In these sorts of issues there are many things to develop.

Human resources are important and thus need to be managed effectively. Getting the most potential candidates is easier if a company has a good reputation and is seen as a successful company. In order to be able to employ and retain the best talent, companies need to provide the employees with decent income and career opportunities.

At some point company D had problems with employee turnover rates, but the situation is getting better. Especially in their middle management and higher executives no longer pose a problem by rapidly changing employers, but factory workers still change jobs frequently. As the labor markets develop, the local population and companies have started to see the negative effects of constantly changing employers.

Company E is not having particular problems with retaining their workforce. As they are going to more technical direction, they need to develop the skillset of their workforce, and as a result finding capable people is not easy. Those who do possess the required skillset know the value of their work and tend to be expensive. Changing a job is relatively easy if an employee gets a better offer. The labor costs are not the same everywhere in China as in the Eastern parts of China they have risen considerably.

Company F manager agrees that there are a lot of good managers in China, but the hard part is finding them, and they are not cheap. The good managers in China are starting to become more expensive than their Western counterparts. In case of company F, the workforce is mainly Chinese with some expatriates in between. At the end of the day, the goal of company F is localization. The employee turnover rate has also been very high with company F, and has been a problem.

As a conclusion, human resources were seen as a valuable asset by all companies. The issues that rose from the interviews differed somewhat from manager to manager, but there were some commonalities between the companies and their supply chains, regardless of their size. The Chinese culture and language are something that affect management of human resources and needs to be addressed. Technical knowledge of employees also raises considerations, as local employees need to be trained, or alternatively expatriates must be brought in to bring technical competencies. Also issues regarding finding and retaining employees was a topic many managers raised, as employee skillsets and turnover rates are much different than in Western countries.

5.2.4 Technological Resources

Of the smaller companies, both companies A and C agreed that technological resources are an important factor for their businesses when doing business in China. Company C manager elaborated on the notion by saying that in order for companies to have something to sell, they need innovations; otherwise you are unable to sell in China. Innovations are also connected to the know-how related to products, because products are copied easily, but processes are copied much slower. This is related to the technical service business, which is also inherent in other markets. According to company C manager, compared to other markets elsewhere, copying is less-existent and more indirect. Once again we see a connection between human resources and technological resources, as earlier mentioned by company C manager describing the significance of human resources in increasing company technological resources in China.

Of the larger companies, technological resources are critical only for company E and connect heavily to its order winning factors. The innovations regarding technological resources are mainly done outside of China. As company D manager points out, technological resources in China behave slightly differently than in Western countries. Company D does not develop anything in China, but rather modifies the existing technology to better fit the local markets. The Chinese are well versed in knowledge of basic technologies, for example regarding building hardware for electronics, but more problematic are the skills that require free thinking skills, for example programming.

Regarding intellectual property rights and illegal copying of technology and products, manager D said that “if you’re afraid of copying in China, you shouldn’t go there”. It’s worthwhile to keep an eye on what is going on and do take the necessary steps to prevent copyright infringements that are preventable, but that shouldn’t hinder companies from doing business in China. Again, good relationships help, and make sure that copyright infringements happen more rarely. If major infringements do happen, the legal department will take the necessary actions against the perpetrators.

In conclusion, the significance of technological resources depends heavily on the company. Copyright infringements are something that occur, but should be taken into consideration. Less existent however, is new technology creation in China.

5.2.5 *Reputation*

All three smaller companies agreed that reputation is very important resource when doing business in China. Company B manager further explained that reputation is built over long periods of time and is very important in working in China. For newcomers this naturally poses challenges. Often assistance from other home country companies is very valuable. If a company wishes to pursue business with Chinese companies, it requires an extended period of time to be spent in China in order to gain trust. The Chinese respect companies that are able to supply Western companies, because they understand the requirements are very high. Gaining personal trust however, which is also required in China, is much harder to gain.

On building reputation, company C manager explained that one needs to understand that China is not a democracy, which is reflected in certain issues. A positive example of this is when a state actor, in this case Finnfund, is participating in financing a company, it immediately creates an aura of respect. “In a way it serves as a life insurance, which is of course very useful. Governmental backing can be very helpful when doing business in China.”

Reputation is also very important for all the three larger companies when doing business in China. Company E is seen as a forerunner within their industry. Generally all products sold in China are divided into two categories: imported and made in China. The first category is generally perceived to be of good quality, but very expensive, the latter the opposite. Despite having a production facility in China, company E has been able to hold onto their reputation as a quality manufacturer.

Company F manager refers to reputation by saying that when it comes to order winning factors, company F is a well-known brand in the marketplace, is a reliable supplier, and has excellent service network to provide for its customers. Good and long-term customer

relationships also contribute to company F's success, as well as the fact that company F is located in China. Reputation is a very important factor in doing business in China.

Reputation is also important for the customers and in the worst case can cause a lot of harm. A competitor of company D was involved in an incident where a person died because of their product. The competitor didn't possess the relationship capabilities to handle the situation in China the way that best suited the local culture, and as a result made a public relations catastrophe. This in effect resulted in negatively affected sales revenue and lost reputation.

In conclusion, reputation is a factor all six companies agree unanimously to be important when doing business in China. Reputation can be increased by various means, including earning it in long-term customer relationships, by being able to supply Western companies, through high quality of products and through government backing for example in loans. It is important to elaborate that in China earning a reputation takes a considerable amount of time.

5.2.6 *Organizational Resources*

On the significance of organizational resources company A manager said that "manager's decision making capabilities need to be very good in China". The rapid pace of change in all sectors of the Chinese society force managers to reduce the amount of purely mathematical optimization and make decisions based on intuition. This has reduced the time of amortization of an investment to three to five years, which is rather short-sighted for Western decision makers. Of course this intuitive way of making decisions will lead to mistakes and misses, but overall is rather effective in a rapidly changing environment.

Of the larger companies company D manager refers to organizational resources as the most important resource, together with human resources. Organizational resources are also very important for company E. Speed at which things happened in China is immense. Everything is done significantly faster than in the West, including decisions. More things happened in one quarter in China, as in one year in Europe.

Company D manager stated that "in China companies need very good managers because the country and the culture is very authoritarian. Leadership skills possessed by managers are somewhat different than the ones that are critical in Western countries." Company D manager said that Finnish leaders tend to be very naïve, in a sense that they believe that everyone is onboard the same boat and going to the same direction. In China, even in same organizations not all people necessarily have the same goals and motives. Managers "need to be able to see games and play games". Managers need to be able to spot the right people and put them into the right place in order to create competition. Company E manager also described similar issues by saying that in China many people

have the need and the urge to succeed, and as a result want good things for themselves personally. Thus it is not self-evident that people share information, because information is power. As a result, people often sit on important information and refuse to share important details. Company D manager stated that managers need to have some China-expertise, but must not be too Chinese. A good manager is a compromise between China and West.

In conclusion, especially larger focal companies placed more emphasis on the organizational resources and their importance. Organizational resources also tended to focus on managing people and leadership, as the qualities leaders need to possess are somewhat different in China. Decision-making speed was also emphasized, as the rapid pace of things happening in China is immense.

5.3 Capabilities

5.3.1 Cost

Of the small focal companies, A and C explained that they do not aim to pursue a cost-leadership strategy, and that would be very difficult to obtain in China. An interesting fact that manager at company B pointed out was that they have to adjust their prices to the levels of the Chinese markets, no mercy is given here. This does not mean that they have to compete with the absolute lowest price suppliers, “father and son in a garage”, also for credibility reasons, but significant cost adjustments need to be made in their business.

Cost divide the larger focal companies, as two of the three large companies consider costs to be a priority. For company D cost-capability is very important in China, as the portion of customers able to buy extremely high quality and expensive products is still rather small. The majority of the markets are dominated by more affordable options.

Company E manager was explaining that costs are always a problem for Western companies operating in China, and overall cost structure needs to be kept track of. Getting costs down is a priority of company E, but as of this moment it has not been as successful in this. Company E has however engaged in activities to lower its costs, for example by cutting excess capacity. Of the three companies company F did not consider costs to be of a high priority, as the manager said that cost is not something company F competes with, since they are not even trying to be the cheapest.

As a conclusion, cost leadership is very hard for Western companies to obtain in China. Half of the companies interviewed had to work on their cost levels in order to stay competitive, whereas the other half was not especially concerned about the cost levels compared to other companies in China.

5.3.2 *Quality*

Quality can be viewed as an important capability for all focal companies. Company A considered quality to be an important factor when working in China. For company B quality is considered a self-evident capability, and becomes particularly significant only in case problems arise. For all the three large companies, quality is important when working in China. As company F manager put it, “without quality you cannot exist.” As such it is one of the three most important capabilities for company F when working in China. For company D cost and quality are very important in China, but the portion of customers able to buy extremely high quality and expensive products is still rather small. The majority of the markets are dominated by more affordable options. Company E customers value technical quality, meaning that they have to produce very uniform quality that is above average in the marketplace. Customers appreciate the reliability of company E, so it is natural that their reputation is high within the marketplace. Despite Company E having higher prices than the competitors, the customers feel that the price quality ratio is very good. Overall the technical quality of the products and the know-how company E employs are key factors why their customers buy their products.

Quality is a key factor to company E when doing business in China. The quality has to be above average so that company E can retain their higher prices. Without keeping up with the quality, the products would fall into the average quality range of products, where the Chinese competitors make sure that competition is fierce. This relates to the innovations company E has made, in order to be on top they constantly have to innovate new things.

Localization has been a goal of company E, and is seen as the key to being able to meet challenges that arise. Too much localization however is not desired, as differentiation is also important. When competition based on price is not an option, companies need to be able to produce different kind of added value than their competitors. The Chinese competitors have engaged in a strategy of producing more and cheaper, but company E has decided to steer clear of this and concentrate their efforts in a few key segments.

To conclude, quality is generally seen as important capability in China, mainly to differentiate from competitors. As the Chinese markets are huge, all markets tend to have a lot of competition, and the way to differentiate is through quality. Quality does not have to be absolutely the top of the line, only better than that of the competitors in the same

product segment. Quality can be especially important, as it is in case of company F. Quality was very important, but on the other hand, as mentioned before, they were the least interested in cost leadership. It would seem that there is an inverse correlation between cost and quality capabilities.

5.3.3 *Flexibility*

For all three smaller focal companies volume flexibility seems to be the most important aspect of flexibility. For companies A and C, flexibility wasn't seen as anything out of the ordinary for business success, whereas company B saw it as a very important capability when working in China. Company A manager elaborated by saying that companies always need to search for customers in order to secure sales revenue. Competition in the Chinese markets is very hard. As a result, smaller companies need to be flexible as much as larger companies in accordance with the markets. The marketplace is what dictates the need and extent to which companies need to be flexible. Volume flexibility is much easier to achieve in China than in Finland, due to the fact that overtime hours are reasonably priced and workers are very willing to work overtime. A Chinese worker generally never turns down overtime.

For company C flexibility is no more important in China, than it is elsewhere. In the industry company C is in, flexibility is a norm which is due to the fast pace of operations and lack of planning in the supply chains. The end-customer is the one making the major decisions, to which the entire supply chain responds to. This however creates opportunities to charge more. These elements of the industry supply chain are typical everywhere in the world.

Flexibility on the other hand is very important for company B. Large customers tend to expect a lot of volume flexibility from their suppliers when buying components. Situations are often not forecastable ahead, rapid changes in situations occur, and as a result the suppliers need to be very quick to react to sudden changes in demand.

It seems that companies A and C have gotten used to volume flexibility requirements set by their customers, whereas company B has had to adjust to the more sporadic nature of demand in the Chinese markets. It also seems that the interviews might support the view that willingness to other types of flexibility could be dependent upon individuals. Company A manager explained that flexibility goes according to the customer, although it is a double edged sword. Too high of a degree of flexibility can easily diminish profitability. The willingness for flexibility is dependent on a person, but there are also differences amongst nationalities. Finns are a small nation, so maybe that is why they are more willing to be flexible when it comes to changes that occur as the project goes along. For

example Germans are not as flexible, as they outright refuse potential for flexibility, or put such a high price tag for flexibility that it becomes infeasible.

Of the three larger focal companies, company F stands out when it comes to flexibility, since flexibility is something that company F has been able to build into their supply chain, and is comparatively faster at making adjustments than their competitors within their industry. Of course flexibility and cost are directly proportional in the sense that as flexibility goes up, so do the costs.

For company E, flexibility is of course important, “but you don’t have to be the best, only more so than your competitors.” The easiest kind of flexibility, price flexibility, is not an option because it immediately has an effect on the financial performance of a company. Flexibility when it comes to delivery times is difficult due to the long transportation distances from Europe to China. To counter this, company E has engaged in some warehousing activities in order to provide its customers with more flexibility, but only to an extent, because warehousing products costs money. An aspect of flexibility, company E has engaged in, is volume flexibility. They are able to deliver various volumes of products based on customer request.

When it comes to product flexibility and custom orders, company E is open for suggestions, but it all boils down to the volume ordered. With some product categories, even very small custom orders are possible, but with standard products customization and product flexibility require greater volumes to be ordered. Also the technical demands of the order might restrict custom orders. The direction company E is on is that the more they want to go into the specialized product segments, the more they need to find the will to customize.

In conclusion, for two out of six focal companies, flexibility was especially important. For the rest of the companies flexibility was seen as important, but as nothing out of the ordinary or particularly important. Flexibility was provided as it was needed, but it was not viewed as especially critical. The most important form of flexibility was by far volume flexibility.

5.3.4 Innovation

None of the smaller companies are engaged in innovations in China, although company C is hoping to establish product development there. As the company C manager stated they have “been able to find staff who speak good English, and for that the wages are similar to those in Finland. The quality is at least of East European standards.”

Innovation divides the large companies. Innovations are very important for company F and as a result company F has invested quite a lot for their innovation capability. Company D has a different approach to innovations, as for example sustainability is something

the Chinese customers ask for and are interested about. It can work as a sales argument, just as innovations, but not as something companies can differentiate with. The most important thing with innovations however is that in China innovations work differently than in the West. In China companies do not necessarily need to invent the newest technologies in order to attract customers, but change their existing products rapidly. An example of this is public sector changing their requirements for procurement of certain kind of product, and as a result companies need to be able to change their product specifications in accordance within just months in order to land deals.

In conclusion, two companies engage in innovations in China, of which one more so by modifying existing technologies to better fit the Chinese markets. Generally innovations are produced elsewhere.

5.3.5 *Service*

According to companies A and B, service wasn't of any particular importance to them, although company C considered it very important. Company C manager explained that the essential aspect is how to integrate customer service capability into the organization. This requires certain moves to be made, and taking multiple perspectives. For example, training a Chinese engineer to consult customers about company's products is a challenge, since technical consultation is the most essential part of company C's business. Overall, most things are quite easy, but to find the right people to work for the company in China, to serve Chinese customers, is more of a challenge. Luckily the Chinese engineers are mobile when it comes to the place of work.

Service is another factor that divides the larger companies. For company D service does not play a major role in China. For company D selling services in China is hard, due to the fact that the concept of service does not really exist as such. The Chinese customers tend to think that if you buy quality, you don't need to maintain or service it. That is why it is hard to sell service to Chinese customers. Again, this is changing, as in some of the coastal cities, selling a product without a maintenance reference is starting to be difficult. For company E, service does not play a particularly great role in doing business in China. The main service they engage in is educating their customers on the products company E has to offer, and how they could benefit them.

Service however is something company F has invested a lot in and is detrimental to their business. They have worked for years to build up the service capability. It is important also in China, due to the very international nature of the business company F is in. Service is one of the three most important capabilities for company F when working in China.

In conclusion, for two out of six focal companies service played a major role in operating in China. Others reported services as working differently in China than in elsewhere, but that the situation is slowly changing.

5.3.6 *Delivery*

For companies A and C delivery was not seen as especially critical in the importance of doing business in China. Company B manager however reported that delivery is not always easy, despite using Western third party logistics providers. As a result company B had to invest in logistics capabilities of their own in order to ensure reliable and timely deliveries of their products. This is also connected to flexibility, since added delivery capability means that company B has more flexibility to offer.

The importance of delivery is a common theme amongst the three large companies. Company D manager explains that delivery speed needs to be good when operating in China. In case of company D this was established through their own production facility in China which helped considerably in them doing business in China. In light of the rapid pace of change that is occurring in China, without the factory they would have been in trouble. Due to the fast pace of the environment, careful manufacturing resource planning is not possible and needs to be done with very broad brush strokes. This of course calls for a lot of managerial judgement, which is a challenge for the production facility.

Company E manager tells a slightly different story by explaining that delivery is a critical factor in the negative sense of the word, meaning that company E does not excel in this capability. They are located far away from the markets which hinders their overall delivery speed, especially regarding the imported very high quality products in the more specialized segments. This in turn hinders the overall success and performance of company E. Within the recent years this has come increasingly problematic, since after the global financial crisis, freight ships have decreased their speeds to save fuel, which directly affects the delivery speeds and thus their overall performance.

When it comes to delivery, local suppliers are important. Customers of Company F are very international, and do business around the world. The Chinese suppliers have been very important for company F for two reasons: costs and localization. The Chinese suppliers are able to bring costs down, and are better able to facilitate company F's localization strategy. Some components however have to be imported from abroad, especially those that the Chinese suppliers do not have capabilities to produce. The importance of manufacturing in China is great and is growing significantly over time.

From the theoretical perspective physical resources affect company's delivery performance by them needing to exist preferably close to the markets. Relationships also contribute to delivery, because local suppliers are more capable for enabling faster delivery speeds than suppliers outside of China. In conclusion, especially for the larger focal companies delivery was seen as very important capability. Problems arise from long distances to Western countries and unreliable delivery infrastructure, but can be countered with localizations and good supplier relationships.

5.3.7 *Relationships*

A matter that all managers from the three smaller companies agreed upon, was that relationships are extremely important when doing business in China. Establishing trust, especially with the Chinese customers is a significant factor of doing business. Orders are not received just by sending a quotation, but need to engage in relationship activities to secure deals. Numbers are not necessarily what matter, business is done between people.

Personal relationships are critical in order to succeed in China, and have to exist on many levels of the company, especially the managerial level. Company A manager also mentioned *guanxi* as an important factor. The *guanxi* networks reach very far and are often very useful, for example in finding both customers and suppliers. There are of course risks associated with *guanxi* and managers need to be aware of how far they are willing to go, for the system of *guanxi* relies on reciprocity. This however should not be mixed with corruption and giving money under the table. Even though corruption is widespread and surrounds Western managers, Westerners should not engage in such activities.

Manager C explained that "it did not take long for company C to find partnerships and the rhythm by which to work in China. The partnerships and the network is not necessarily a very formal one, and the partnerships are based on projects." For company C, since they have been in China for a relatively short period of time, relational capabilities are built with universities. Their aim is to "find and build relationships through a technical path, and find the bright men of the future to work with". At the moment company C does not have major client relationships, but hopefully in the future this will change.

An important question that company C manager raised and that which all companies large enough face, is whether or not they need partners. Company C has made the decision not to join forces with a local company into a partnership, but to work alone. As company C manager put it, "if we had chosen a partner, we probably would already have a lot of sales, but there would be other problems". Many companies have gotten into partnerships and found themselves in situations where they no longer "hold all the strings". With Chinese partners, companies can be quick to get up to speed, but it is worthwhile thinking

what the long term plan is. “In China, the local partners often want a 50/50 ownership, but are willing to provide only 10% of the finance because the local know how is considered so valuable.”

The significance of relationships is also something all three large company managers agree upon. Company D manager describes relationships to be the most important capability a company can have in China. In Europe good relationships with customers help of course, but in China they are the key to success. Company D used a network of agents to connect with customers, establish relationships and sell products. The hard part with agents is that each province and even a smaller area needs its own network of agents, because the agents are local players. The question is how to build up an effective network of agents. Company F manager also explained that “in China relationships are something from which everything begins from, and without relationships nothing exists.” Relationships are one of the three most important capabilities for company F in China. Company F’s goal is to operate in a very localized manner in China, striving to create good relationships with customers, suppliers and governmental authorities. In China it is very important to know the right people. Company E manager explains that relationships are very important in China, because, “without good networks, many things would take far longer to complete and many doors would remain closed, so relationships definitely are important. You can’t start calling strangers like I can in Europe. I need to know the friend of a person I’m trying to call so that things can even get started.” Relationships are also evident after making one or two transactions with the customer, because the customer relationship stands on much firmer ground. This significantly decreases the chance of customer running away with another supplier.

Company E employs a network of sales companies around China. The customers are generally wholesalers, but company E also delivers products for some end customers. Relationships are also very important in China from the perspective that company E has customers who have been buying their products for a very long time. However company E has not engaged in joint marketing efforts with their business partners. Building relationships with the wholesalers is very hard because their behavior is very inconsistent, and as a result the relationship is very sporadic, business is done only when both parties feel it is a good time to do business. The main concerns within the business transactions are price and quantity. The turnover of customers is relatively big, around a quarter of customers each year are new. Partially this is because company E is trying to establish itself with a new market segment, instead of competing with local suppliers about standard product markets.

In China, especially in larger projects where there are multiple parties involved, recognizing the party and the person who makes the decisions is very important. This is often difficult due to the amount of parties involved in both execution and planning, and in

general multiple things happening at a very fast pace. Recognizing the person who, in the end has the authority, is a critical skill. That is the only way to have an effect on anything.

Managing supplier relationships has also been identified as very important. Company D reported of a local supplier cluster that they operated very closely with. Suppliers were viewed as customers, because company D wanted to establish excellent relations with them. The reason for this is that good quality relationships made doing business easier, and made sure that the suppliers would provide company D with their best quality. In the product markets, company F is striving to find the best suppliers that can provide the best quality goods due to the fact that company F itself is known for its quality. To do this, company F is investing in long term relationships with suppliers, because there are many different kinds of suppliers in China.

Relationships also tend to be very personal as company E manager explains. In business relationships the Chinese value putting yourself personally on the line. This can be seen in spending free time with customers and drinking excessive amounts of alcohol. Exposing oneself like that shows that business does not rely merely on contracts, but on personal trust. Even though you can't see it, it is worthwhile to be aware that relationships carry a great significance in doing business in China.

In conclusion, relationships seem to be very important in supply chain management in China. This applies to both upstream and downstream of the supply chain, as both customer and supplier relationships need to be managed effectively. Relationships have a significant impact on a variety of things, and tend to be very personal.

5.4 Small Companies Supply Chain Adaptation

Changes that company A has made include investments in the planning power of a company in regards to managing projects. This translates to additional staff to project management. Also investments in the training of employees has been made. Investments in human resources have been seen as necessary and establishing SOPs for every position of the company have been made to negate the negative effects of high employee turnover. Measures of safety have been needed to be put in place due to the insufficient safety measures enforced by the government and the local companies. A watchdog post has been issued to make sure that company A knows what is going on in the Chinese end of their company. In the theoretical framework, this means adaptation regarding the organizational resources as well as human resources have been made. Measures taken have led to better relationships with the Chinese counterparts. Relationships are important, because the Chinese are rather loyal customers. The first deals often have to be made with zero

profits, but once the business relationship has been established, the Chinese customers prefer to stay with the same supplier. Thus investments in relationships are necessary.

Investments have also been made to be able to provide larger volumes in China. This is for two reasons. Firstly larger volumes help to push costs down, which is a necessity in the Chinese markets. Western companies can never compete with the Chinese companies when it comes to price, but lowering costs lowers the threshold for Chinese companies to choose Western suppliers. The second reason is that when the customers are Westerners operating in China, they require the supplier to be able to provide rather large volumes to be even considered as potential supplier. Many smaller Finnish companies have had to come back from China, because they went there after a single customer and supported by too loosely granted public money, only to find themselves in trouble for not being able to sell to Western companies due to lack of capacity and not being able to sell to the Chinese due to too high costs. In the theoretical framework this translates to adaptation made regarding the physical resources of the supply chain, which in turn affect flexibility and costs.

Company B originally started their operations in China in procurement, finding and sourcing components. When they wanted to make the transition towards selling to customers in China, they realized the natural step would be to establish a sales organization. This however was not simple. Company B tried using their sourcing professionals, social individuals who enjoyed spending time at the target market, to sell products instead of buying them. This did not work due to the sourcing people's inability to close deals. In the theoretical framework this translates to changes made in relationships, as they also compose of selling products, after which changes to human resources were made.

From there company B expanded to manufacturing in China, a business process they were already familiar with in Finland. Nowadays company B has a manufacturing facility in China, because they understood that the rising costs and the currency getting stronger meant that sourcing in itself from China is not a sustainable path. The final justification to expand manufacturing to China was the opportunities company B saw in the growth of the Chinese markets, and the decision was made to expand manufacturing to China.

In the theoretical framework, changes in the product markets made it more lucrative to invest in physical and human resources by building a manufacturing site, which in turn affected the supply chains delivery capability as well as relationships capability, as it includes sales.

Company B started out by selling to other Western companies in China, and after that moved on to selling to Chinese companies as well. At the moment the customers are for the most part Western companies, especially Finnish, operating in China. The components company B is selling come from both Western companies and from China. The customer base of company B in China is mainly other manufacturing companies. Relationships and credibility with other Finnish companies operating in China were easily

built through the common language and background, since both company B and their customers had Finnish personnel in China. This was intensified by the connections that also existed in home country. In the theoretical framework, reputation and connections through human resources, i.e. Finnish employees in the home country, helped to build relationships in China.

Company B has had to build good relations with the suppliers in order to keep the quality of the suppliers constantly high, although even this might not be a guarantee. Constant quality checks and audits must be put in place. As a result of some quality issues from suppliers, company B has to import some components to China. From the perspective of the theoretical model, good ongoing relationships help with quality, but the product markets force company Bs supply chain to import components, potentially affecting volume flexibility and quality.

Company B started out in a business park in a modest location, but as their business expanded they had to find a more spacious location. The place chosen was relatively far from the city center, and company B had to start their own bus line for the employees. This stiffened the working hours, and as company B put it: “when the bus was about to leave, everybody’s pens hit the table”. This was a challenge that was resolved by finding a new location closer to city center and next to better transportation connections. In the theoretical framework investments in physical resources, i.e. better location, boosted the supply chain capabilities, because without such investments efficiency would have been impaired by stiffness’s in working hours.

As the cost level in China is getting higher and the exchange rates are moving to more disadvantageous direction, the use of China as a manufacturing hub from where products are sold in other markets is decreasing. In the theoretical framework cost increases in the product markets and labor markets delivery to markets outside of China has decreased as the costs to manufacture have gone up.

Overall when it comes to adaptation in China, company B manager sees it as very important; “if you see something is not working you need to have courage to change it. In China, one needs to be patient, because it takes time to learn the way of doing things. Of course establishing oneself in any foreign country takes time, but China especially requires a very long time. Every day you learn new things, new surprising things. One has to be prepared for surprises.” He also adds that “the local customs and culture are very different and learning them is very important. Westerners can’t change things, or at least have to modify corporate culture to better fit the Chinese culture. Leadership is more direct, giving orders and giving specific assignments, more so than in Western countries. Documentation has to be done very specifically, because losing face is feared and thus people are afraid of telling their bosses they don’t understand the given instructions.” This correlates with adaptation regarding human resources and organizational resources from effects of political and social environment.

Company C originally started in China by manufacturing products for other markets. Later it has started to sell to the Chinese markets as well. The main customers of company C are located globally. In the past, company C has gotten into new markets through small scale testing, which has worked very well. Now they are approaching the Chinese markets in a similar fashion. By first producing products in China for other markets, company C has been able to create an organization, which can later be modified to sell to the Chinese markets.

The Chinese market is very different from other markets when it comes to company C, because the industry company C engages in already exists in other parts of the world, but not in China, where it is still taking its first steps. In other words the market is still at its infancy. To create the market, company C has partnered with other Western companies to try to create a market for their products by doing joint projects to establish a need for their products. The idea is to create a demand and show the customers they need the products company C provides. As a result the initial market growth is still slow. Through the partner network company C has been able to create contacts through which to sell products. However the sales process through a partner network is very different from that in Western countries. From the theoretical perspective, the lack of product markets in China regarding company C's products has forced company C to invest in a very slow pace to physical resources, and more so in relationship capabilities in order to create a market for their products.

It did not take long for company C to find partnerships and the rhythm by which to work in China. The partnerships and the network is not necessarily a very formal one, and the partnerships are based on projects. In the theoretical sense, informal relationships favored instead of formal ones could be a result from political and social system, which has a direct effect on relationships.

An integral part of company C's internationalization is the fact that they start small, and develop their organization slowly through experimentation and doing. Full speed accelerations are not possible in China or elsewhere. When entering a new market, company C often starts small with a limited staff to practice and experiment, and scale up later. Market researches are considered pointless, as "you need to do and experiment through hands on experience. Time will tell if the market is a success."

In conclusion, small companies and their supply chains have invested in physical resources, human resources and organizational resources in order to boost their relationship capabilities, flexibility, as well as their delivery capabilities. Adaptation is made both to fit better with the Chinese product markets, as well as to the surrounding cultural environment. Other types of adaptation exists as well, but these seemed to be the main cases when it comes to smaller companies.

5.5 Large Companies Supply Chain Adaptation

For company D the success in China started from a realization that the Chinese customers were not interested in an innovation that was core to company D's success in Western countries and part of the company's identity. As a result company D had to modify their product to better fit the markets and also change their sales and marketing strategy. An additional change that involved marketing was made, which concerned the sales channels; previously company D had used distributors to sell and market their products, but changed that to the use of agents. The sales model included agents, who would connect company D and the customer and help build a relationship, company D selling the product and signing all the contracts, and finally company D delivering the customers with the products. Since China is becoming wealthier, company D has needed to develop project capabilities in order to better cope with rising demand with more flexibility.

From the theoretical perspective, product markets forced company D to adapt through innovations and increase their relationship capabilities through modifying their human resources and organizational resources. Added flexibility can also be attributed to the increased organizational resources.

Within the last few years, company E has increased their presence in China by building new facilities to better serve their customers. They have also formed a sales organization and expanded their sales network. All this has been done in order to form new sales channels and to work more closely with the customers. Company E has also tried to strengthen their channel control and to see the entire supply chain as a whole. In human resources the company has been investing in personnel, training and other related things. This has been done to support the moving away from the more or less standardized products to more specialized segments, where more knowledge is required of the personnel, but where volumes and profitability have been found to be good. From theoretical perspective company E has moved to different segment of product markets, and increased their relationship capabilities through adapting their human resources and organizational resources. Delivery has been increased through added physical resources.

The major changes company F has done while in China have been added localization. The company started in China with a lot of expatriates, but has over the years reduced the amount of expats and let the Chinese take over the business. Company F has decided to produce the more standard products in China and the customized products in Europe. When it comes to relationships, the Chinese like to do business with Westerners and appreciate Western high level managers stationed in China. To develop their relationships, company F has moved some high level executives to China so that they can better cultivate these relationships and understand the local business environment.

From theoretical model, major changes to human resources and organizational resources were made in order to better the relationship capabilities in China. Increased production of standard products in China have been achieved through adding physical resources in the form of manufacturing facilities.

One manager said that “he feels sorry for companies that try to remote control their business operations in China. If you want to come to China, you have to do it long term and you have to actually come there. You cannot try a little, but come with a bang. Whether it be building a factory or something else, you cannot do it remotely, but actually come on the spot to do it. It is also quite an investment to come to China and is a huge commitment. It takes time to build relationships and to feel and experience the business environment, and be known. It doesn’t happen just suddenly.”

In conclusion, with larger focal companies the adaptation focused even more so on human resources, organizational resources and physical resources. The capabilities increased differed from company to company, but what all large companies and their supply chains had in common was increases in relationship capabilities. Delivery capability was also increased in some cases. With larger focal companies, a tendency to adapt to the cultural environment, as well as the product markets was also visible, just as it had been with the smaller focal companies.

5.6 The Most Important Institutional Factors

Based on the interviews and analyzing the coded data found in appendix 1, there are three institutional factors that seem to be significant in order to better understand the business environment Finnish companies and their supply chains operate in. These three institutional factors seem to be the Chinese culture, fast-paced business environment, and finally managing labor force.

The Chinese culture as an institutional factor is evident in the relative importance of relationships in managing supply chains. Based on the interviews relationships need to exist both with customers, as well as with suppliers. Good relationships have many effects, including helping to keep the quality of suppliers high, in preventing copyright infringements, as well as managing contractual relationships through trust, rather than through legal coercion. The Chinese culture is evident in many facets of the business environment. In the theoretical context the effects of Chinese culture can be placed in political and social system in the institutional framework of the theoretical model.

The second institutional factor Finnish companies and their supply chains in China face, is the fast-paced business environment. According to the interviews, a constant theme in supply chain management in China, is how fast changes occur. The pace of

doing business has a tremendous effect on order delivery processes, planning, as well location decisions. The fast-paced business environment can be placed in the product markets in the institutional framework of the theoretical model.

The third institutional factor Finnish companies and their supply chains face when doing business in China is managing labor force. The size of the Chinese labor markets is vast and many companies face problems from very high employee turnover rates. At the same time wage inflation is high, and finding skilled managers seems at times to be a challenge. The third institutional factor, managing the labor force, can be placed in labor markets in the institutional framework of the theoretical model.

These three institutional factors and their effects on supply chain management in China are examined based on their effects on resources and capabilities in the later part of this chapter.

5.7 The Effects of Institutions on Resources and Capabilities

After establishing the most important institutional factors affecting Finnish companies' supply chain management in China: the Chinese culture, fast-paced business environment and managing the labor force, those institutional factors and their effects on resources and capabilities were charted. The basis of the charting was clear indications of connections based on the interviews. For example if the political and social system clearly affects human resources, this connection is recorded. Analysis on the number of connections was conducted and figures were created presented below. In the figures, the thickness of each connection represents the number of times mentions were made. This provides an overview of the strength of connections between institutions, resources and capabilities having on each other. In addition to these figures a logic model was created with more detailed explanations of how certain aspects of institutions have an effect on the resources and capabilities of supply chain management in China. Together the figures and logic models should give a clear understanding on both the strength and the quality of relationships between different aspects of Finnish companies supply chain management in China.

The first figure concentrates on the effects of Chinese culture on the resources and capabilities for Finnish companies operating in China found in figure 12 below. The clearest connections appear to exist between political and social system, human resources and organizational resources. Also the connection between human resources and relationships is very strong. The basis of these connections is the distinctly different cultural environment, which emphasizes relationships over contractual arrangements. A clear pattern seems to emerge, that personal relationships are the driving force in the Chinese institutional environment. As a result investments in Human Resources and Relationships were, based on the interviews, seen as necessary and important.

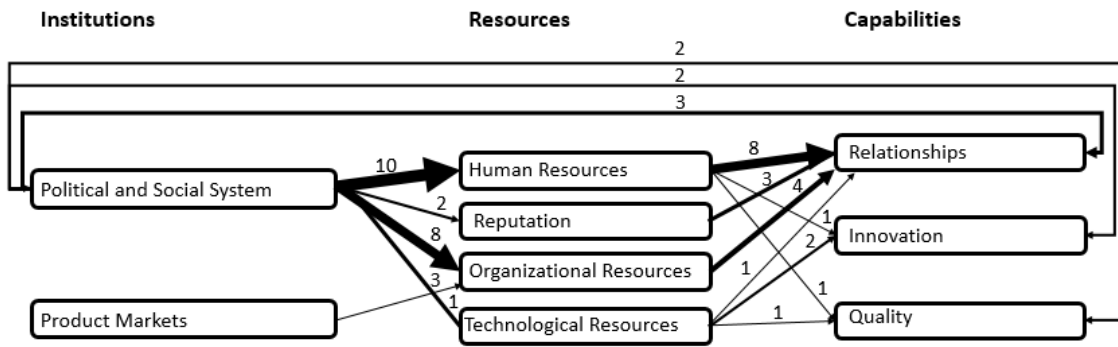


Figure 12 Chinese Culture on Resources and Capabilities

The connections come from the fact that investment in sales organizations and agent networks have been made in order to make the supply chains fit better to the surrounding social system. These investments were made to take advantage of the high regard for relationships. Long-term relationships are favored over arms-length relationships. In order to cultivate better relationships, some companies even moved high ranking company executives to China. The high regard for relationships is also shown in the fact that contracts are often trust based, rather than relying on the strict letter of the written contract. As the social and cultural environment differs vastly from what Western managers are used to, all this means that investments in human resources and localization have been made.

Organizational resources have also been under a strain as a result of added human resources. Western managers have had to adapt to the Chinese social system and leadership culture. Training vast amounts of Westerners has been seen as time-consuming and ineffective, so training the local staff instead, is seen as a viable solution, especially since local employees are often the key to more localization. As relationship-based management is vastly different from contract-based management Western companies are often used to, organizational resources have been improved. The combined effects of fast-paced business environment and more intuitive way of thinking inherent to the Chinese social system, organizational resources and project planning power have had to be adjusted in order to cope with the surrounding business environment.

This is also represented in the more detailed logic model of each connection shown below. All the following logic models use the same symbolism in their depictions, as explained by figure 13 below. The institutional factors of the business environment are depicted with dashed boxes. General phenomena are depicted with thin lined boxes. Significant effects of institutional factors and phenomena on capabilities are depicted with boxes that have thick lines, and significant effects of institutional factors and phenomena on resources are depicted with boxes with compounded thick lines. This depiction is meant to be an approximation of the content of the boxes, and not as an absolute indication, as many of the factors cannot be unambiguously categorized.

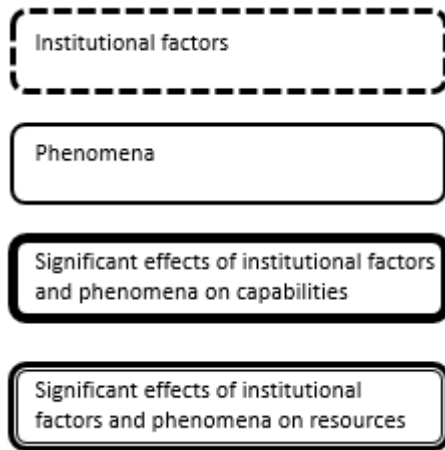


Figure 13 Logic model explanations

The logic models details the effects of Chinese culture based on the following logic presented in figure 14 below. From there it is clear that the different aspects of Chinese culture have clear indications on organizational and human resources of a supply chain. The connections and importance between political and social system and organizational resources is partly explained by the fact that copying is seen as more acceptable in China than in the West. This is also related to what Westerners perceive as differing moral code, since legal framework has less of a significance than one’s own morals compared to West. The difference in perceptions over morals is also evident in the management of contracts. Since business is done between people and is based on trust, contracts are seen as “just paper”. This however does not mean contracts would not be abided by, but rather that the contract has more of a symbolic meaning representing the agreement between people.

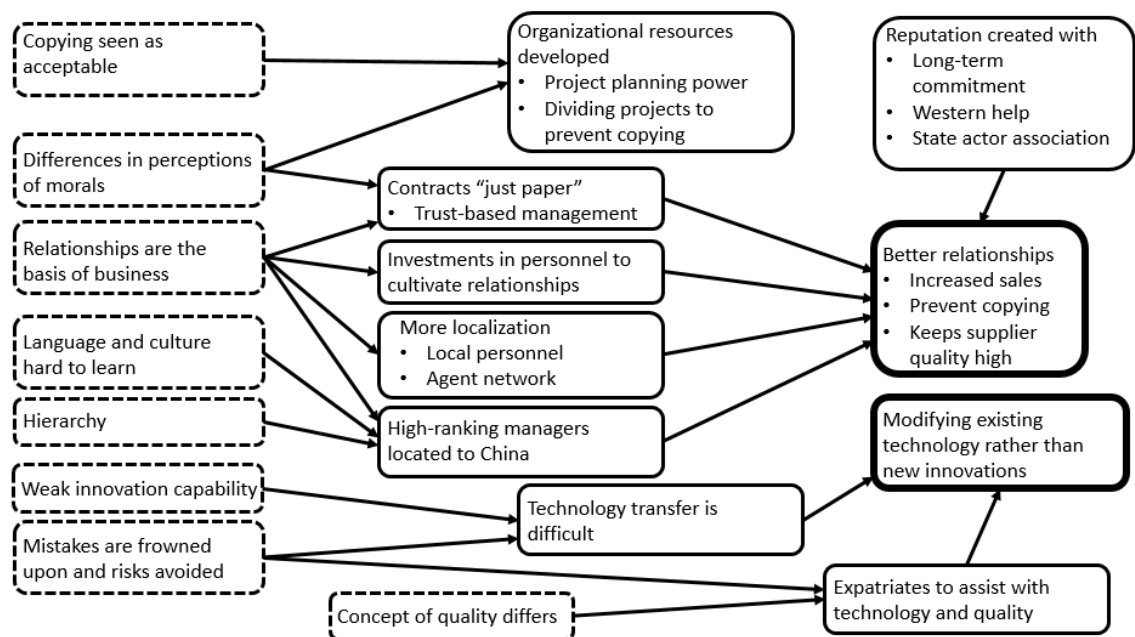


Figure 14 Effects of Chinese Culture on Supply Chain Management

Relationships are seen to affect many aspects of supply chain resources. Investments in human resources and the cultivation of personal relationships are very important in the Chinese culture. As the social and cultural environment is difficult for Westerners to learn, a natural conclusion is to invest in localization and local personnel who already know and understand how to operate in such environment. Establishing local sales organizations and agent networks has also been commonplace to take advantage of local know-how. Localization does have some challenges due to the effects of appreciation of hierarchy in Chinese culture. The Chinese managers appreciate meeting people of the same hierarchical level in an organization. To accommodate this, high level Western managers have been sent to work in China to create relationships with customers and suppliers. When it comes to human resources, a good mix of localization and high level Western managers adapting to the Chinese culture and social system creates good results.

Reputation has also been important in a social system that relies more on relationships than the strict letter of the law, and as such reputation has been a priority for supply chains of Finnish companies operating in China. Creating a good reputation in China takes time, as the markets are extremely big, but there are things Western companies can do to increase their reputation. Often supply chains of Finnish companies can assist in building good reputation through joint projects with other Finnish companies and help them to expand their relationship networks. In a hierarchical political and social system as China, government cooperation or backing in the case of Finnfund can also be seen as a valuable tool to create good reputation. All this helps to create better relationships, which are critical in supply chain management in China.

Technology and innovations are also connected to the social system, as the innovation capabilities in China are often lacking. Risk aversion and avoidance of making mistakes have had clear effects on employees since the time they have been in school, and as a result this, creating novel innovations in China is rather difficult. This and other factors contribute to technology transfer being difficult from Western countries to China. This is another case where expatriates can provide some assistance, as they can bring competencies and Western quality thinking into organizations. Rather than trying to innovate completely new products and innovations, companies have found it to be more beneficial to modify existing innovations to the Chinese markets, where industry standards can vary considerably.

To conclude, Chinese culture affects supply chain management in China vastly, especially in the importance of human resources and organizational resources. Dissecting the social system has led to a conclusion that Chinese culture affects the institutional environment significantly and is required in understanding the business environment. The main effects of Chinese culture, when it comes to capabilities is the extremely high significance of relationships, which changes the dynamics of doing business Western companies are used to. Relationship and trust-based management should be preferred over

contracts, both in customer and supplier relationships. Ways to achieve this include investments in human resources, creating a good reputation, and having high ranking Western managers to accommodate the importance of hierarchy. Good relationships will contribute to finding and retaining customers and will increase sales performance. Because of Chinese culture, innovation capability in China is weak. Having Western expatriates accommodate modifying existing technology to the Chinese markets has been seen as an effective way to technological resources to the Chinese markets. As copyright infringements are commonplace, supply chains need to invest in organizational resources to divide their project into smaller sections that are far more difficult to copy, as well as keep good ongoing relationships with their suppliers and customers, as this reduces the risk of copyright infringements. Innovation capability should also be of importance. This however does not mean that companies and supply chains need to produce new innovations, but rather that existing innovations need to be modified as quickly as possible in accordance to the varying requirements set by the local business environment.

The second institutional factor that affects supply chain management in China is the extremely fast-pace of the business environment. This means that the time in which deals are closed and deliveries made is much shorter than in Western countries. Investment decisions, for example, are made very quickly with much shorter amortization times in mind. Connections can be seen in the figure 15 below. The clearest connections can be seen between the product markets, physical resources and organizational resources, of which physical resources are extremely connected to delivery capability.

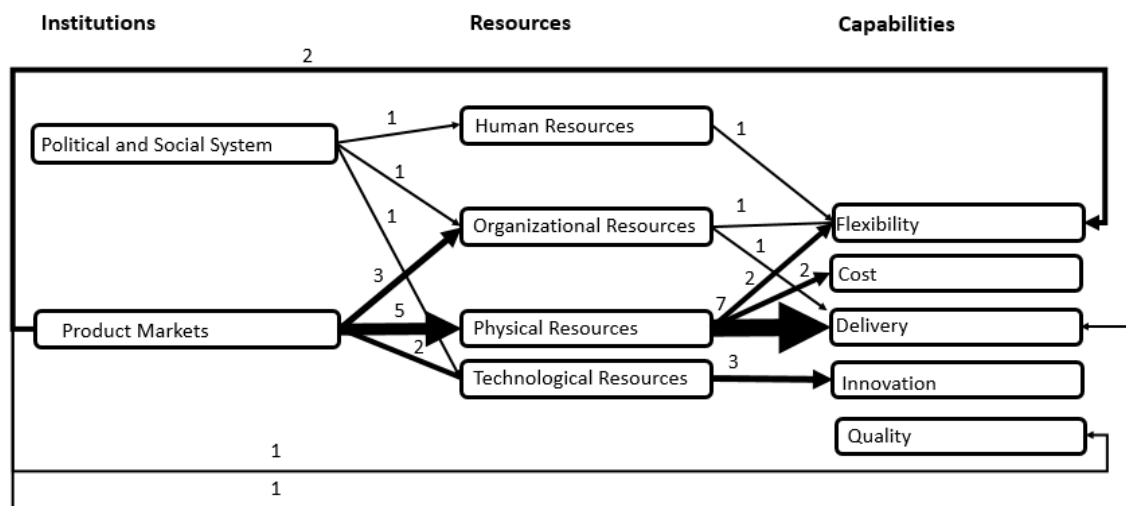


Figure 15 Fast-Paced Business Environment and Resources and Capabilities

Other important connections are between product markets and flexibility. These connections represent the effects of fast-paced business environment on the physical resources, decision making capability as well as delivery. In addition to decision making and delivery capabilities being important, innovation capability and technological re-

sources are also important. This however does not mean producing genuine new innovations, but rather reflects the need to modify existing technology to fit changing industrial and local standards. Based on the interviews established product standards are often lacking, in which case the supply chains that can modify their existing technology to the new requirements the fastest is at an advantage.

Another result of the fast-paced business environment is the rapid changes in demand, which leads to added requirements of volume flexibility. Achieving sufficient capacity to meet the volume flexibility requirements, requires further investments in physical resources. Luckily the local workers are often very willing to work overtime, so human resources offer flexibility. Increased capacity requirements place more emphasis on capacity utilization and are reflected in rising costs, which can become a problem.

Figure 16, the logic model below, illustrates in more detail the effects of fast-paced business environment on the organizational resources and capabilities a supply chain has. The two main components are fast-pace business environment, as well as the long distance to Western markets. Based on the interviews this creates the need for supply chains to have their production facilities located in China. If production facilities were located in Europe, the lead times would stretch too long in order to effectively respond to the fast business cycle. This also places much emphasis on the organizational resources, as careful production planning is often impossible and has to be done more intuitively. As a result investments in physical resources and organizational resources have had to be made. Due to the lacking technological resources and quality issues, some high quality components are still delivered from Western countries.

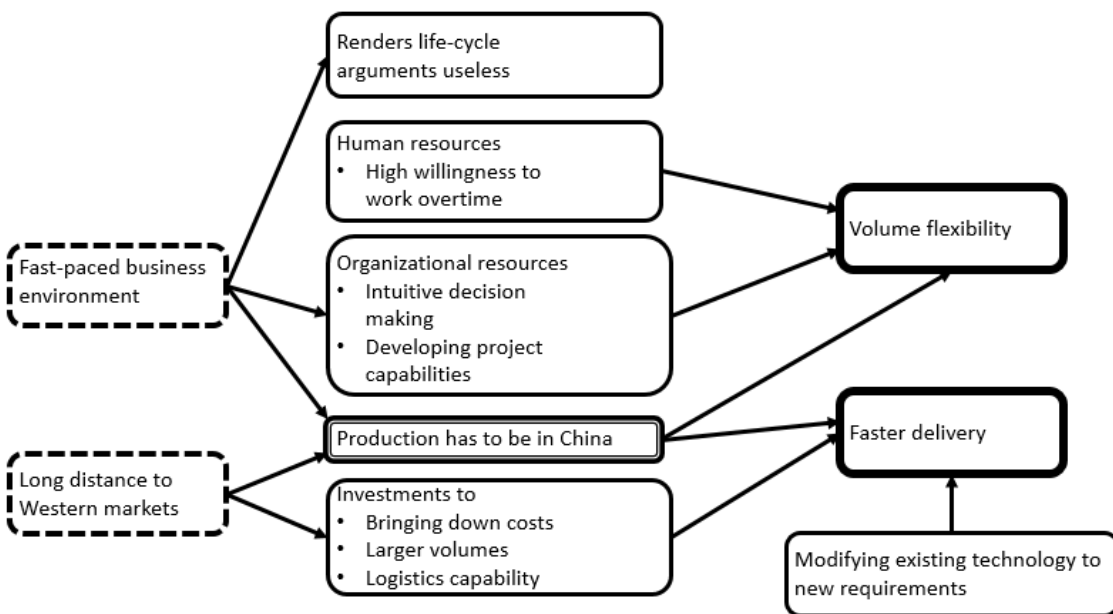


Figure 16 Effects of Fast-Paced Business Environment on Supply Chain Management

To conclude, the fast-paced business environment poses a whole new dynamic for supply chain management of Finnish companies. Organizational resources and physical resources are managed rather intuitively as purely mathematical optimization becomes impossible. The effects of fast-paced business environment are further enhanced by the long distance to Western markets. As a result production facilities have to be located in China in order to fulfill the requirements of fast delivery and volume flexibility posed by the Chinese markets. Speed is a key advantage and supply chains have to adapt to become faster. This applies also to technological resources and innovations as existing technology needs to be fitted to the Chinese markets.

The third major institutional factor affecting supply chain management of Finnish companies in China is the managing labor. Figure 17 below describes the strong connection between labor markets as well as political and social system to human resources. This is rather intuitive and could be speculated to exist in any market.

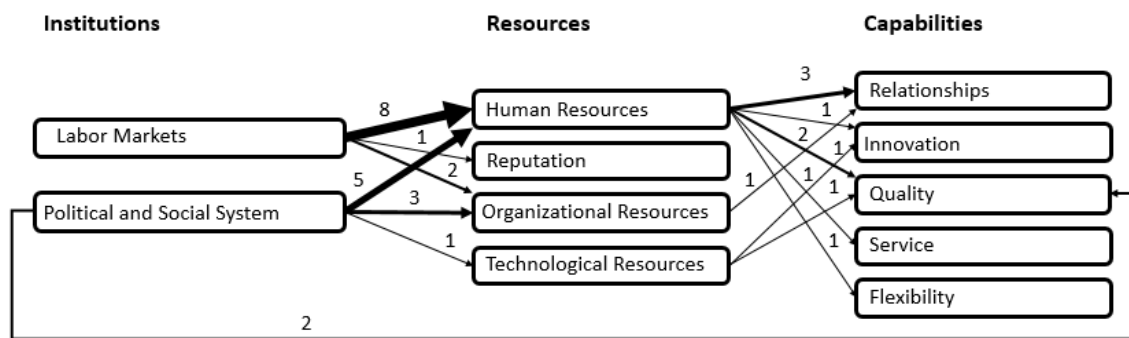


Figure 17 Connections between Labor Force and Resources and Capabilities

The varying connections of human resources to most capabilities could also be regarded as rather intuitive. To give us a more clear understanding on the effects of managing labor force in China, a logic model in figure 18 was created detailing the different aspects that affect supply chain management of Finnish companies in China.



Figure 18 Effects of Labor Force on Supply Chain Management

Based on the interviews the labor markets in China are vast but underdeveloped. Finding untrained workers is easy, but high employee turnover and wage inflation creates problems. To counter the fast turnover of employees standard operating procedures (SOPs) have been created for every position, that detail the procedures and responsibilities of each employee. However, as the required skillset grows, so does the difficulty of finding more skilled workers. Good reputation helps in finding, recruiting and retaining workers. Good salaries as well as lucrative career paths also helped in retaining workers. Cultural differences and the skillset of untrained workers has made managing human resources challenging. Lack of knowledge in the English language, culture of avoiding mistakes and differences in the concept of quality have been identified as the major challenges. This translates to difficulties in understanding blueprints, technology transfer as well as utilizing information technology. This has also created a need for Western expatriates to help in bringing competencies and technical knowledge to the organizations in China.

As the culture and language pose challenges and need to be understood in order for managers to be effective, localization has been seen as a solution to counter problems associated with the different social system. Training expatriates in the language and culture takes a long time and is demanding, which further supports the notion of local managers taking responsibility. When it comes to hiring managers, finding skilled, experienced managers who know English can be difficult, especially for smaller companies. The larger companies did not view this as especially difficult. What all managers agreed

with, was that capable managers were very expensive. Again, good reputation of a company helped to find and hire the best talent, as well as to retain them.

Overall, managing labor forces creates an interesting situation where both Western expatriates and local managers are needed, but in vastly different positions. Even though localization was the goal of Finnish companies' supply chain management activities in China, expatriates were seen as important resource for Western supply chains in bringing competencies and technological knowledge, as well as to act as watchdogs to prevent unlawful activities. This however was mediated by the need for Western managers to adapt to the local culture and customs. Local managers were left with the responsibility to run sales networks and agents. Finnish or Western way of doing things was not seen as superior, but rather as just different. The ideal manager was said to be a compromise between Western and Chinese management style. Another notion that rose from the interviews was the commonness of joint venture entities where Western party provided the technology and Chinese party provided the local know-how. This seems to be a well-functioning arrangement, provided that the terms and conditions of the joint venture agreement are fair for both parties.

5.8 Critical Resources and Capabilities

An analysis of business critical resources and capabilities was conducted and the number of times a resource or a capability was mentioned or insinuated as critical was recorder. This was done to provide a different perspective in analyzing the data. The results, which are presented in table 4 below, from both large and small focal companies were relatively similar; human resources clearly being the most important resource to all supply chains. Technological resources, physical resources and reputation were also mentioned as important. The major difference between large and small organizations however, was that managers from large companies placed high emphasis on organizational resources, whereas managers from small companies did not mention organizational resource as a business critical resource in supply chain management in China. The reason for this could be that the significance of organizational resources grow only after an organization has reached a certain size. In companies large enough organizational routines, structure and other factors become more important in effective management.

Mentions or insinuations of critical business factors

All companies

Resources		Capabilities	
Human Resources	11	Relationships	8
Organizational resources	3	Quality	4
Technological Resources	5	Delivery	4
Physical Resources	5	Service	2
Reputation	4	Flexibility	1
		Cost	1

Table 4 Critical Business Factors, All Companies

Of the capabilities that were perceived as important, relationships took a clear lead as the most important capability. Quality and delivery were also seen as important, but to a lesser extent than relationships. Overall it would seem that human resources and relationships are the most important resource and capability in supply chain management and doing business in China. This could support the notion that Chinese culture is the most significant institutional factor the companies interviewed would have to adapt to.

5.9 Adaptation of Supply Chains of Finnish Companies in China

The adaptation of supply chains of Finnish companies in China concentrated on two main facets of the Chinese business environment. The first one being the adaptation to the Chinese culture and high regard for relationships in supply chain management, and the second one to the fast-paced business environment that was evident in manufacturing business.

The first kind of adaptation was set forth by the effects of Chinese culture on the Western supply chains in China, which is represented by figure 19 below. The effect of Chinese culture on Western supply chains translates to high regard for personal relationships when doing business, at times overriding other business priorities. To adapt to this, Finnish companies and their supply chains established local sales organizations and agent networks, as well as invested in building long-term relationships with both customers and suppliers to better fit into the business environment. In addition to relationships, other facets of Chinese culture were affecting business relationships. Hierarchy was also evident in the need for higher managers to be located to China, both so that top managers could forge relationships with their peers, but also so that they would better understand the local business environment. Cultural adaptation was also evident in Finnish managers needing to adapt to the Chinese business environment, as well as to the Chinese leadership style. These relationships extended to both customers and suppliers, as both contributed to the performance of supply chains in question.

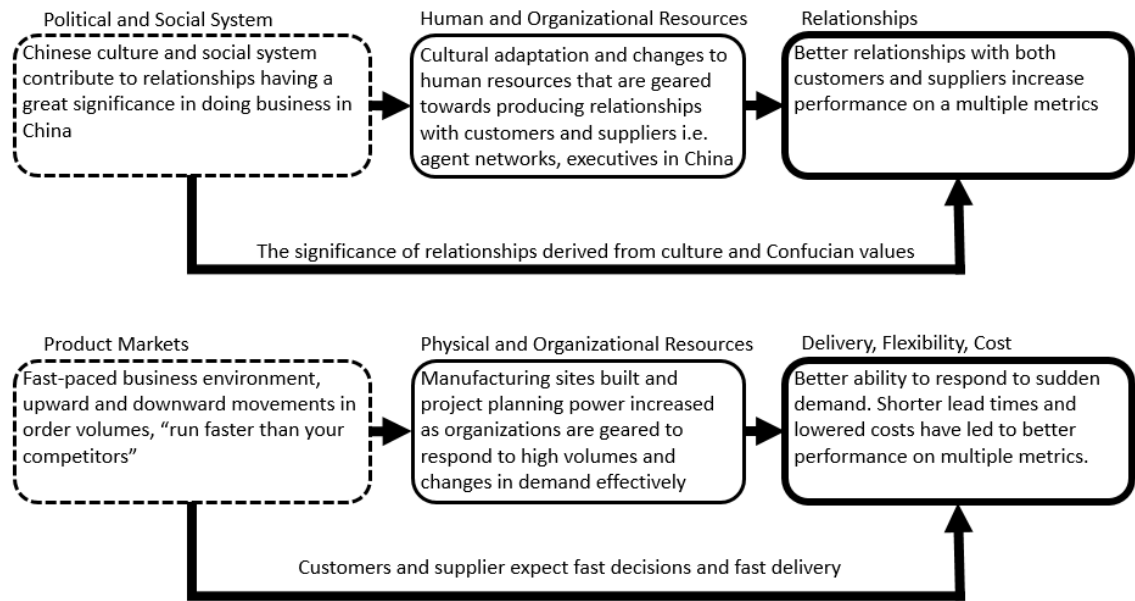


Figure 19 Adaptation of Supply Chains of Finnish Companies

The second type of adaptation was regarding the fast-paced business environment located far from Western markets. Fast upward and downward movements in demand were commonplace, which forced supply chains to adapt their physical resources as well as organizational resources to better be able to respond to changes in demand. As the Chinese markets are used to fast-paced business transactions, they were expecting their Western counterparts to do the same. Purely mathematical optimization, which the Western companies had used to, was very difficult, and more intuitive ways of production planning were put in place. Manufacturing sites were built and project planning power increased, and as a result the delivery, flexibility and cost capabilities were enhanced. All this adaptation meant that supply chains were performing better on multiple metrics.

Other adaptation that occurred was related to the management of human resources to counter the negative effects of large employee turnover rates. This was done by issuing standard operating procedures for every position, which also assisted in training workers with poor skillsets. One company also had to adapt the technological innovations that were critical to them in other markets, so that they would better fit the Chinese markets. These two cases of adaptation presented here were evident in one or more cases, but were not deemed as common as the two types of adaptation presented above. This is not to say they are not significant, but that further research is needed to confirm their commonality and significance.

6 DISCUSSION

This chapter concentrates on comparing the results of this thesis with the literature review in order to gain a better understanding of the phenomena under examination. This analysis is done through examining the three most important institutional factors in the analysis in the previous chapter. The goal of this chapter is, to a degree, to explain the Chinese institutional environment and how it affects supply chain management of Finnish companies in China by converging the interview material and the literature review. The end result is a synthesis of information that should give a better understanding of supply chain management of Finnish companies in China.

6.1 Social System

An important factor that needs to be taken into consideration in supply chain management in China, is the social system. The social system includes the language and culture. It is important to mention that relatively few people in China speak English and it takes a very long time for Westerners to learn the Chinese language. Also according to one manager learning the culture is close to impossible.

Interestingly, this might not be supported by the literature review. By mirroring the interviews to the literature review, we can find support for the notion that Chinese business environment is understandable and learnable, as long as we understand the underlying dynamic behind the culture. Based on the literature review Chinese culture is heavily influenced by teachings of Confucius, and by examining the social system and business environment through the perspective of Confucian thought we could be able to better understand the social system and how it affects supply chain management in China. Therefore in order to understand the business environment one needs to understand the teachings of Confucius (Jacobs, Gao, Herbig, 1995, 33-34). This was also supported by Keller and Kronstedts research, who pointed out that the two most critical factors for long term success in China are Confucian values and *guanxi* (Keller & Kronstedt, 2005, 61). Confucian values are based on four main ideas: harmony, hierarchy, the building of moral potential and kinship (Buttery & Wong, 1999, 149).

6.1.1 *Harmony*

Striving for harmony can be observed in quality thinking and dealing with mistakes. One manager gave an excellent example of this: “the Chinese are very good at avoiding discussing problems and acknowledging problems”. This would break harmony in the

organization. An exaggeration was used to describe the severity of the situation by saying that “if you bring up a problem, even as a messenger, you are punished and that they rather spend 20 hours hiding a problem than spend an hour fixing it”. This is supported by the literature, as it is common that employees are being punished for mistakes harshly and reprimanded publicly for breaking harmony in the organization (Wong, Maher, Evans, Nicholson, 1998, 18). The striving for harmony could also be observed with the example of one of the managers, who was asked in a meeting if he wanted to drink coffee or tea. After stating coffee with milk and sugar was his preferred choice he was brought a cup of tea and told it was much better for him than coffee. It can be speculated that admitting the Chinese side did not have coffee would have broken harmony, so tea was given instead. Another example of preserving harmony was given in a situation where the Chinese party was unwilling to give a straight answer to a question regarding the date of completion of a certain action. Giving a particular date for the completion of this action has the potential of breaking harmony, in case the date is not actually met, and thus answering vaguely, i.e. “we will do our best” is the best answer in order to preserve harmony. (Wong, Maher, Evans, Nicholson, 1998, 18.)

The Chinese management style emphasizes “stability in life, serenity of an organization and peace of a community” in order to instill harmony (Lin & Chi, 2007, 195). The concept of harmony extends in a chain from an individual level of peaceful body and mind to a peaceful family. From there it extends to a societal level to community with progress and finally to a nation with wealth and peace, in which people are living good lives with good careers (Lin & Chi, 2007, 195).

6.1.2 Hierarchy

In order for harmony to exist in the society, people need to know their place and how to behave (Kaunonen, 2011, 62-63). Hierarchy can also be seen in values. It is a very important factor in shaping Chinese organizations and managerial and leadership practices. It has created distinguished characteristics of the Chinese managerial and organizational system. (Sheh, 2010, 280-281.) Westerners who do not understand the importance of hierarchy in the Chinese society can be facing problems. The Chinese managers will often act inhospitable or impatient if they are not dealing with a person of similar level in hierarchy, preferably the president or CEO of a Western company (Wong, Maher, Evans, Nicholson, 1998, 18). The effect of hierarchy can also be seen in managers having hierarchical paternalistic obligation to their employees. Decisions are often made behind closed doors. The main goal however is harmony, rather than control. (Yazdani, Murad, Abbas, Gondal, 2011, 262-263.)

In the interviews it was stated that in China companies need very good managers because the country and the culture is very authoritarian. This extends to the political system, as there has always been a strong leader in China. According to one manager it would be hard to imagine China as a Western democracy. This also extends to the Chinese workforce, who are used to authoritarian way of leadership. In China the responsibility is with the manager. The leader is responsible for the completion of the task and has to make sure the employee has understood the assignment, started it et cetera.

Additional example of authoritarian leadership was given by another manager who explained that in “Western countries the underlying assumption is that as long as you have the numbers and facts in order, you should be correct. In China even validating the numbers need to be done by a higher authority.” This was also supported by literature, as accepting Western culture of directness, meaning for example concentrating only on facts without involvement of emotions, is often not accepted. (Jiang 2013, 111.) The manager also explained that in China, it is important to openly show your support for the leader. In return the leader will support you.

6.1.3 *Building of Moral Potential*

According to Confucianism the basis of leadership is virtue rather than law (Sheh, 2010, 280-281). This explains why the legal system of China is relatively weak (Gao, 2006, 120). In the case of China, this relates heavily to intellectual property rights that are governed by virtue rather than law. As one manager said: “Compared to other markets, in China copying is more-existent and more direct.” The reason being is that in Western view, intellectual property rights and innovations are seen as private property because that way it preserves incentives to invest in innovation. The Confucian view on the other hand emphasizes commonness of all even in intellectual property rights and the responsibility of those who have the know-how to those without. Therefore intellectual property is seen as common good. (Kit-Chun, 2003, 159-160.) Making changes to the legal system regarding intellectual property rights has very little effect on how business is conducted. In traditional Chinese thought, intellectual property did not exist. The views on intellectual property were not found in laws or legal codes, due to the fact that profiting from artistic production is low-class and immoral. (Lehman, 2006, 7-8.) As a result when it comes to doing business, Intellectual Property rights need to be taken seriously.

The mentality of virtue over law can clearly be seen on the issue of contracts and trust. As one manager put it “contracts are generally abided by and thus contracts do have significance. Whether or not it is always needed to write a paper is another matter.” An-

other manager put it slightly differently by saying that “when it comes to making contracts, the Chinese don’t pay much attention to the actual written contracts. Trust is more important than the written contract.” He conclude the issue by saying “contracts are just paper”. Contracts are seen as recordings of what has been established in negotiations, but the terms can be changed later. As such contracts are not seen as binding (Wong, Maher, Evans, Nicholson, 1998, 20). Also contractual-based relationship management can be seen as imposing control, or in other words, is seen in a negative light. Trust-based relationship management should be preferred. (Al-Khatib, Vollmers, Liu 2007, 92-93.)

6.1.4 Kinship

“In China everything begins with relationships, and without relationships nothing exists” was how one manager explained the significance of relationships. A matter that all managers who were interviewed agreed with was that relationships are extremely important when doing business in China. “Numbers are not necessarily what matter, business is done between people. Personal relationships are critical in order to succeed in China, especially with the Chinese management. Relationships have to exist on many levels of the company” said one of the managers when emphasizing the importance of relationships. Another manager added that “In Europe good relationships to customers help of course, but in China they are the key to success. Relationships are the key to localization.” This is connected to the concept and importance of kinship, which is heavily influence by Confucian thought, as mentioned earlier in the literature review. Confucianism also affects *guanxi* (Gong, He, Hsu, 2013, 374) in which kinship and family are natural *guanxi* bases, but others exist as well (Tsang, 1998, 65).

Guanxi bases are significant in China, as one manager said: “You can’t start calling strangers like I can in Europe. I need to know the target persons friend so that things can even get started.” *Guanxi* (关系) as mentioned earlier refers to “particularized and personalized relationship based on the reciprocal exchange of favors” (Dong-Jin, Pae, Wong, 2001, 52). *Guanxi* is not something that is created over a visit or two, but rather over longer periods of time (Keller & Kronstedt, 2005, 62).

The main problem in establishing *guanxi* often comes from the lack of trust. As mentioned earlier, Western and Chinese concepts of trust are very different. Westerners tend to separate trust from head and trust from the heart, or in other words trust that is reserved for social life and for home. Examples of this are emotional closeness, rapport and empathy. The Chinese see little separation between the two concepts. Achieving rapport and trust on both levels will give better chances of forming *guanxi* in the future.

(Chua, 2012, 29-33.) This was evident in the depiction of one manager: “In business relationships the Chinese value putting yourself personally on the line. This can be seen in spending free time with customers and drinking excessive amounts of alcohol. Exposing oneself like that shows that business does not rely merely on contracts, but on personal trust.” As mentioned earlier, Guanxi is heavily influenced by the legacy of Confucianism, because of to the high regard for harmony and hierarchy. As a result harmonious interactions between people are valued and sought after. (Dunning & Kim, 2007, 331-332.)

In the context of Chinese and Westerners, it is vitally important that all actors must establish and understand their place in the three circles of guanxi. Once this is achieved, actors need to follow the rules of the circle they are positioned in. Obviously, it is difficult to learn the rules of the different levels of guanxi and acquiring necessary resources and capabilities to engage in appropriate activities. Difficulties arise from the different rules in different contexts. The rules vary from relationship to relationship, so in each new relationship, rules need to be explored and determined separately. Rules of the relationship may also change as the relationship changes, so they need to be re-examined from time to time. (Gao, Ballantyne, Knight, 2010, 266,271.)

Liabilities also exist. For example when a person who holds good guanxi with an individual in an organization, suddenly asks for a very big favor. (Tsang, 1998, 70.) This was also mentioned by one manager: “guanxi is an important factor for success. The guanxi networks reach very far and are often very useful, for example in finding both customers and suppliers. There are of course risks associated with guanxi and managers need to be aware of how far they are willing to go, for the system of guanxi relies on reciprocity. This however should not be mixed with corruption and giving money under the table.”

6.1.5 *The Pursuit of Good Life and Good Career*

A topic mentioned repeatedly throughout the interviews was that people in an organization did not necessarily share the same goals. One manager said that “Finnish leaders tend to be very naïve, in a sense that they believe that everyone is onboard the same boat and going to the same direction. In China however, even in same organizations not all people necessarily have the same goals and motives.” Another manager described a similar situation by saying that “in China many people have the need and the urge to succeed, and as a result want good things for themselves personally. Thus it is not self-evident that people share information, because information is power. As a result, people often sit on

important information and refuse to share important details. This difference in mentality probably comes from the urge to “make millions in a moment”.

This is possibly derived from the teachings of Confucius. The pursuit of “good career and good life” is an important goal in Confucian thought (Lin & Chi, 2007, 195), although it could be attributed to other factors as well. As the profit motive has become more apparent following China’s shift towards a free-market economy, and even Deng Xiaoping famously saying “To get rich is glorious”, the selfish profit motive that has emerged could be a more viable explanation (Ip, 2009b, 214). Nevertheless varying goals of individuals are a factor of the Chinese business culture. To counter this, one manager suggested that “you must always ask yourself why a person is talking a certain way. It can lead to cynicism, but people tend to have a selfish motive to act in a certain way. A good question to ask is where the money is going and who is making money and how. This will often clarify many situations. As a balancing force between playing games and the pursuit of money, the concept of face exists to provide the Chinese with longevity in doing business. The concept of face establishes that people have something to lose.” The urge to succeed could also be connected to the high level of openness in the Chinese society. As one manager put it, “As long as the new idea or thing is of use and utility to them, they are willing to change their behavior.” High employee turnover rates could also be at least partly explained by the aspiration for good life. Almost all managers explained that at some point of the company’s history in China, high turnover rates of employees had been somewhat of a problem. As one manager described: “Sometimes even after signing contracts people might not show up because they have already changed employer.” This could also be attributed to the fact that the Chinese do not view written contracts to be binding (Wong, Maher, Evans, Nicholson, 1998, 20). To counter the high turnover rates, Finnish companies have tried to create lucrative career paths for their employees, which has reduced the turnover rates. The pursuit of good life and good career could also be seen in attitudes towards entrepreneurship. “Many Chinese dream of founding their own company and becoming entrepreneurs. The attitudes towards entrepreneurship differ vastly compared to Finland, and are much more positive.”

As the legal system of China is relatively weak (Gao, 2006, 120) and contractual-based relationship management can be seen in a negative light, and trust-based relationship management should be preferred (Al-Khatib, Vollmers, Liu 2007, 92-93), it is no wonder that reputation is regarded as important in doing business in China. One manager described the situation by saying: “reputation is built over long periods of time, and is very important in working in China. If a company wishes to pursue doing business with Chinese companies, it requires an extended period of time to be spent in China in order to gain trust.”

In addition to creating personal trust and relationships with the Chinese businesses, Western companies have a few advantages they can utilize in order to create a better reputation. Two examples were given, the first being that “the Chinese respect companies that are able to supply Western companies, because they understand the requirements are very high”. Thus Western references could yield positive results in building reputation. Another example about building reputation was given by another manager who explained that “one needs to understand that China is not a democracy, which is reflected in certain issues. A positive example of this is when a state actor, in this case Finnfund, is participating in financing of a company, it immediately creates an aura of respect. In a way it works as a life insurance, which are of course very useful. Governmental backing can be very helpful when doing business in China.”

Even though innovations and technology were in general seen as important in succeeding in China, most companies produced their innovations elsewhere. According to one manager “the innovation capability in China being weak, due to their education system and leadership culture. Mistakes are frowned upon both in school and at work, which does not encourage people to take risks. If an employee fails at a task, the mistake is taken off of his or her salary and a picture of him is posted on the wall.”

As mentioned earlier, this is due to the Confucian view, which encourages risk aversion and thus has not been able to cope with the risk-taking mentality needed in innovating in a knowledge based economy. (Kit-Chun, 2003, 159-160.)

Mirroring the interview data with the literature has revealed that the Chinese social system appears to be a mystery, until one begins to examine it through the perspective of Confucian thought. Thus it is appropriate to update figure 14, depicting Chinese culture to a more accurate form that takes the Confucian thought into consideration as well. The updated figure 20 is seen below.

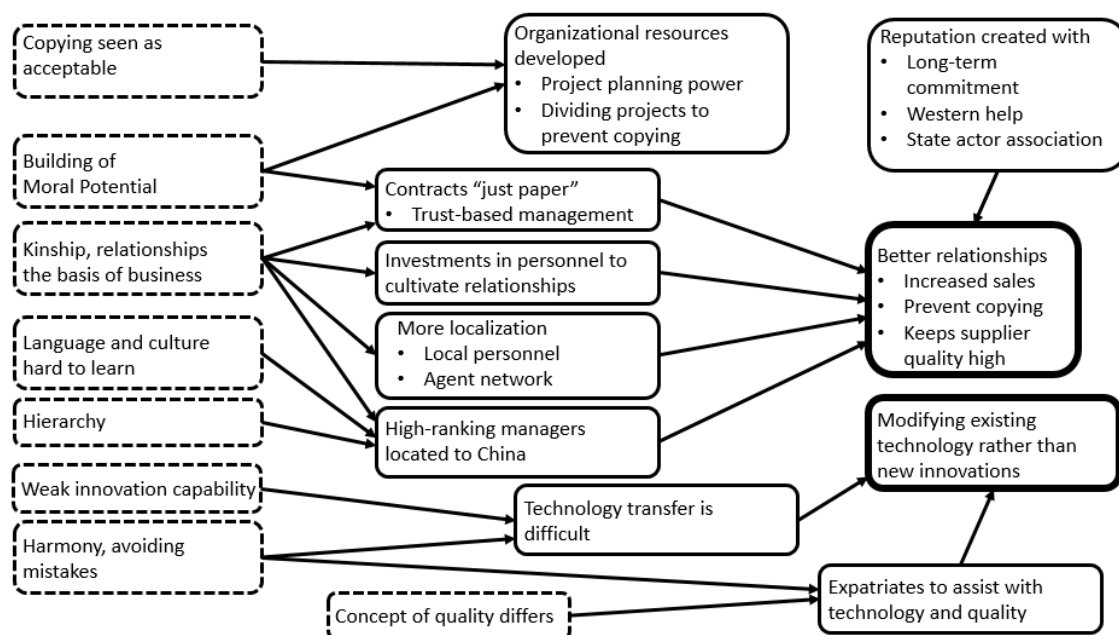


Figure 20 Effects of Confucian Thought on Doing Business in China

In figure 20 the parts changed are all located on the left, which include building of moral character instead of differences in perception of morals, kinship in addition to relationships the basis of business, and harmony instead of mere “mistakes are frowned upon and risks avoided”. These aspects have been updated to better and more accurately represent how Confucian thought is affecting doing business in China.

To conclude, many aspects of the Chinese business environment can be traced back to Confucian thought and the concept of *guanxi* (Jacobs, Gao & Herbig, 1995, 33-34), (Keller & Kronstedt, 2005, 61), and have a major impact on Western companies doing business in China. The ways in which the Chinese culture and social system affect Finnish companies doing business in China is represented in figure 20. The comparison between the interview data and literature would suggest that the Chinese social system is in fact understandable, provided that it is examined from the right perspective. The social system also seems to have a significant effect on supply chain management of Finnish companies in China.

6.2 Fast-Paced Business Environment

Fast-paced business environment was established as one of the three most important institutional factors affecting supply chain management of Finnish companies in China. This has is evident from the fact that from the late 1970’s when China started its economic reforms towards free-market economy, China has grown 10% every year. This growth rate is the fastest in the entire world (World Bank) and as a result China has quadrupled the per capita income since 1978 (Fairbank & Goldman, 2006, 406). The fast growth rates

as well as the size of the Chinese markets became evident from the interviews. As one manager explained: “the rapid growth in China poses a whole new dynamic to doing business”. Another manager explained that “there are more things happening in China in a quarter than in Europe in a year.” The majority of managers explained that the fast growth in China and the fast-paced business environment are a definite factor that affects doing business in China.

As a result of how the fast-paced business environment affects businesses, companies have needed to accelerate their decision making processes. “Run faster than your competitors” was an advice given by one manager. Another manager said that “Speed is an advantage”. Accelerated decision-making capabilities translate to the need of increased organizational resources, which organize, combine, and manage all the other resources of the company (Russo & Fouts 1997, 537). In addition to fast-paced business environment, business can also be very sporadic, resulting in fast upward and downward movements in demand, adding the need for flexibility, particularly volume flexibility, which needs to happen without excessive incurred costs (Swink, Narasimhan, Kim 2005, 432). In practice, rapid deviations in demand accompanied by the fast-paced business environment render market data useless, as it generally tends to be outdated quickly. As mentioned earlier in the literature review, supply chains need to adapt in order to become better equipped for economic upturns and downturns. (Christopher & Holweg 2011, 65, 80) The speed of the adaptation process is important (Militaru & Zanfir, 2014, 146) especially in a turbulent environments. Based on the literature adaptation and the need to adapt are always contextual to the surrounding environment. (Dreyer & Grønhaug, 2012, 1274.) In China the adaptation to the surrounding environment is especially important, as the surrounding business environment, based on the interviews is especially turbulent.

Other effects of the fast-paced business environment are that it renders purely mathematical optimization, in many cases, useless and makes decisions based on intuition much more common. This has an effect both on investment plans, as amortization times tend to be much shorter than in the West, as well as product planning. Careful manufacturing resource planning is not possible. Naturally intuitive way of making decisions will lead to mistakes and misses, but overall is rather effective in a rapidly changing environment. This puts a strain on supply chains’ organizational resources, as well as the need for volume flexibility. Shorter investment times also lead to life cycle arguments being of lesser importance when selling products.

The size of the Chinese markets is also huge, as China now produces over 50% of the world’s products (Lu 2009, 451). This also became very apparent based on the interviews as especially smaller companies need to find their own niche in the markets, because they are virtually unknown. It is easier however if the company is working on a narrow sector. As mentioned earlier, copyright infringements are an issue in the Chinese product markets confirmed both by the interviews as well as by the literature review (Lane, 2013,

175), (Williamson & Yin 2014, 33). During the interviews the managers provided a few examples of how to negotiate the problem, the first one being to divide larger projects into smaller pieces, so none of the suppliers have a clear view of the end result. The second way to negotiate the problem was good ongoing relationships that help prevent copyright infringements. Both possibilities have an effect on the organizational resources, human resources and require high level of relationship capabilities from a supply chain. This is because more coordination is needed and cultivating relationships need to be given a priority.

Evaluating supplier quality through intermediaries (Khanna, Palepu, Sinha 2005, 10) is also troublesome since, according to interviews, supplier quality might drop quickly after sample products. Selection of suppliers thus becomes critical (Moser, Kern, Wohlfarth, Hartmann, 2011, 796). Again in the interviews, good relationships with suppliers were suggested as a solution for potential supplier quality problems. This puts a strain on the organizational and human resources of a company, and require good relationship capabilities to mitigate the potential problems. In this sense it is clear that the Chinese product markets have not yet matured (Khanna, Palepu, Sinha 2005, 10).

In conclusion, fast-paced business environment poses major challenges for supply chain management of Finnish companies in China. The fact that rapid changes in demand pose problems comes to show that even though supply chains might have dynamic flexibility, meaning flexibility within their existing supply chain configuration, more is needed in order to achieve structural flexibility, meaning flexibility of the actual supply chain design (Christopher & Holweg 2011, 64, 70). Alternatively supply chains could strive to utilize better relationships in order to lessen the high volatility of demand and the effects of fast-paced business environment.

6.3 Labor Markets

Based on the interviews and literature review, labor markets in China are vast but undeveloped (Khanna, Palepu, Sinha 2005, 8, 13). This essentially means that due to the size of the labor markets, finding workers is easy, but the majority of the managers reported high employee turnover rates. “Even 25% of the employees could change jobs in a single year” was how one manager described the severity of the situation, although even higher turnover rates have existed. High employee turnover rates that caused problems were also reported in the literature (Kasper, Muehlbacher, Kodydek, Zhang, 2012, 165). Competitive salaries and lucrative career paths within the company help in retaining workers. Standard Operating Procedures must be written for every position to mitigate the problems caused by high employee turnover rates. In addition, according to the literature review, cultural differences, availability of educated Chinese workers and managers

as well as differing goals amongst collaborating partners have all been identified difficulties in China (Gebauer, 2007, 2). Interviews supported this notion that finding skilled workers is relatively difficult, and as a result companies need to train vast amounts of new employees. Again, written SOPs assist lower the difficulties of training new workers. Salary inflation is high, so the cost of labor is increasing rapidly. Knowledge of languages tends to be very low, so for example IT systems need to be localized to the local language.

The issue of recruiting managers divided opinions. Some managers expressed that skilled, managers are not difficult to find, but they tend to be more expensive than their Western counterparts. Others reported that there are a lot of managers available, but finding experienced, capable managers who knew English and IT were very hard to find. All managers agreed that good managers tended to be very expensive. Finding, hiring and retaining employees, top level managers in particular, are some of the key issues when evaluating the maturity level of a countries institutional environment from the perspective of labor markets (Khanna, Palepu, Sinha 2005, 8, 13). In case of China it seems that the labor markets in this regard as well, are underdeveloped.

The combination of the factors mentioned above is resulting with difficulties in managing human resources, which most companies placed high importance to. The importance of having Western managers as a part of management is high. Therefore expatriates are a very important part of the labor force. In general legislation regarding work laws tends to be comparatively more relaxed than in Finland, and workers were eager to work overtime.

6.4 Adaptation

Based on the literature, small and large supply chains adapt differently. Smaller supply chains are more adaptable and persistent over time in stable networks, whereas larger supply chains are found to be more adaptable and persistent over time when network connections are constantly changing. (Hearnshaw & Wilson, 2013, 461.) In the case of supply chains of Finnish companies in China it was evident that both small and large companies were striving for stable network connections with trusted supply chain partners. This would suggest that a limited amount of network connections was more optimal, than a large amount of network connections. Since this thesis did not dwell on the number of network connections, more research is needed to conclude on this matter. It could however be speculated that with stable long term relationships a smaller number of network connections could yield better results, also in terms of mitigating the negative effects of fast-paced business environment.

In addition, literature review suggested that organizations would be keener to adapt tangible issues, such as logistics, products and production processes, whereas adaptation

regarding human resources, organizational behavior and organizational structure was undervalued (Schmidt, Tyler, Brennan, 2007, 535). Based on the interviews this was not the case with supply chains of Finnish companies in China. Major adaptation was done to facilitate adaptation regarding non-tangible issues mentioned above. The literature however agreed with the interview results, in the fact that, investments in adapting human resources and organizational structure were motivated by the desire to build trust and make investments in dyadic relationships (Schmidt, Tyler, Brennan, 2007, 535). Behavioral adaptation (Knoppen & Christiaanse, 2007, 222) was also evident based on the interviews, which in the context of Chinese-Western business relationships has considerable benefits (Jia, Lamming, 2013, 534,535, 546). As the interviews did not dwell into specifics of particular business relationships, dyadic adaptation between Finnish companies and their Chinese partners was left unexplored. It is a topic of future research, as dyadic adaptation relies on good ongoing relationships, mutual trustworthiness and as such does not rely on contracts but on trust (Canning & Hanmer-Lloyd, 2002, 631), factors that are central to the Chinese business environment.

Based on the literature review, a model was created to illustrate the drivers of adaptation. As mentioned above, behavioral factors as drivers of adaptation were strongly presented. Uncertainty and cost were also evident through the adaptation to the fast-paced business environment. These three drivers were all very strong in initiating the adaptation process of supply chains of Finnish companies. Power factors were however different. Non-mediated source of power; expertise power and referent power, which relate to power gained through expertise and admiration could be viewed as effective in the Chinese business environment, as the Chinese businesses are open to new ideas, and value reputation. As the literature review and the interviews suggested, power through legal coercion in a society that values harmony, is not advisable (Al-Khatib, Vollmers, Liu 2007, 92-93).

Christopher and Holweg (2011) have proposed that many supply chains today are not adapting because they are geared towards reacting to external complexity through control, rather than by embracing the complexity. This means that many companies assume stability and are based on forecast-based planning. Supply chains should instead strive to understand the root-causes of volatility and build simple models to help them mitigate this volatility. In addition to supply chains striving to become more flexible within their own supply chain set-up and operations, they should also strive for flexibility in the supply chain design. This means that companies should move away from efficiency thinking and assumption of stability, to a management-style that adjusts the resources, capabilities and set up of the supply chain in such a way that would be the most flexible and best able to cope with turmoil in the surrounding business environment. (Christopher & Holweg 2011, 70.) Needless to say, in a rapidly changing business environment such as China, where volatility is especially high, the only supply chains that do survive are the ones that

are able to cope with the volatility. Based on the interviews, many companies have had to leave China as they have not been able to cope with rapid development speed and high volatility. As such, both dynamic flexibility and structural flexibility are key issues to resolve in order to succeed in China.

According to the interviews, adaptation based on the key contingencies has yielded good results. Managers who were interviewed seemed to have grasped that volatility is a force to be reckoned with and one needs to expect the unexpected. Based on the interviews companies in focus have taken steps to achieve adaptable supply chains, as mere stability and efficiency are not sufficient for succeeding in China.

7 CONCLUSIONS

According to contingency theory it has become evident that the so called best practices do not necessarily achieve the best results in all business environments. As such there has been a shift from best practices (Sousa & Voss 2008, 698) towards finding the best strategic fit between the internal capabilities and external conditions (Mezner & Johnson, 2005, 120). The aim of this thesis has been to identify the institutional factors affecting the supply chain management of Finnish companies in China and to examine the ways Finnish companies and their supply chains adapt to the Chinese business environment in order to form a better strategic fit.

In researching the Chinese business environment, three major institutional factors were eventually identified: Confucian thought, fast-paced business environment, and managing labor. The Confucian thought has many implications on companies operating in China, mainly the high regard for personal relationships in doing business, disregard for written contracts and intellectual property rights and weak innovation capacity, to name a few. The main contribution of this thesis is that although the Chinese culture, which heavily affects the way business is done in China, is seemingly difficult to understand, it becomes much easier to grasp if examined through the perspective of Confucian thought. The four main ideas of Confucian thought; harmony, hierarchy, building of moral potential and kinship, directly affect the way Finnish companies and their supply chains operate in China. This was through the quality thinking and avoidance of bringing up mistakes, through the need to place high-level executives in China to cultivate relationships with people of the same hierarchical level, through dividing systems into multiple suppliers to prevent copyright infringements, and finally through high regard for personal relationships in doing business both with customers, as well as with suppliers. Understanding Confucian thought and adapting supply chains to address the four main ideas of Confucianism seems to lead to higher performance, both in managing customer relationships, as well as managing supplier relationships.

The second institutional factor that was identified, the fast-paced business environment, also has implications on how supply chains are structured, as this means that they need to invest in local production, rather than suppling from Western markets due to the long distances in between the two. The fast-paced business environment translates to the need for rapidly responding to changing demand. This means that the lead times from Western countries would extend too long. Also the need for volume flexibility was evident, as demand could change sporadically. This places pressure on the production planning and the organizational resources of a company, as the fast-paced business environment forces them to become more intuitive in their decision making. An additional factor to the fast-paced business environment is the lack of industry standards, which creates the

need to rapidly modify existing innovations to newly emerging local standards, rather than producing new original innovations.

The third institutional factor affecting supply chain management of Finnish companies is managing the labor force. The labor markets in China are vast, but undeveloped, which has implications on the supply chain management, as well as technology transfer. The main issue with labor is that the employee turnover rates are high, which has created the need to write SOPs for every position within a company. The SOPs in turn help in training new employees. Hiring new labor is also problematic because finding skilled labor is at times difficult. The lack of skilled labor makes technology transfer and utilizing IT systems in particular difficult, as the understanding of technical blueprints and IT systems in English is challenging. The Chinese culture and language are especially hard for Westerners to learn, so the training of local employees has been seen as the best way to achieve skill levels necessary. Despite training vast amounts of locals, there seems to be a clear need for expatriates to bring competencies and technical knowledge. Western managers also need to adapt to the Chinese culture, and a compromise between a Western and Chinese manager has been identified as ideal.

Adaptation of supply chains of Finnish companies to these institutional factors was examined through the theoretical framework created for this thesis. Using this framework two main forms of adaptation were found to exist. The first entails the adaptation of human resources and organizational resources, through cultural adaptation and gearing the organizations to facilitate the high regard for personal relationships. This was done both upstream and downstream of the supply chains. Good ongoing relationships were seen as the most important capability of supply chains in the Chinese business environment, and enabled sales, supplier quality, as well as some protection from copyright infringements.

The second form of adaptation was adapting the physical and organizational resources of a supply chain to be able to respond to fast-paced business environment, as well as to fluctuating demand. Investments in these two resources yielded better delivery, flexibility, as well as cost capabilities through enhanced ability to respond to sudden demand, shorter lead times, and lowered costs.

Overall the analysis regarding the institutional factors, their effects of resources and capabilities, the analysis regarding the adaptation of resources and capabilities, as well as the analysis regarding the critical resources and capabilities all seem to converge and suggest that the best strategic fit in China is achieved by gearing supply chains to facilitate personal relationships and fluctuations in demand, by embracing Confucian thought and high volatility in the markets place.

7.1 Managerial Implications

As the understanding of the Chinese culture and language can be a daunting task, examining the social system through the perspective of Confucian thought can yield remarkable insight into how the society works. Understanding the implications of harmony, hierarchy, building of moral character and kinship can help Westerners to better understand the Chinese culture and its nuances. Acknowledging that the Confucian thought has a tremendous effect on how the society works and how business is done can help Westerners to better understand the culture and modify their own behavior and expectations.

This thesis has dealt with the formulation of *guanxi* (关系), the “drawing on established connections in order to secure favors in personal relationships” (Dunning & Kim, 2007, 329). As it has been shown in the literature review, *guanxi* can enable many new opportunities (Dong-Jin & Pae, 2001, 58), contains risks (Tsang, 1998, 70), and is notoriously difficult task to establish for Westerners (Chua, 2012, 28). Still, cultivating an environment where the establishment of personal relationships and *guanxi* networks can be of use for supply chain management of Western companies in China. As mentioned earlier, the two most critical factors for long term success in China are Confucian values and *guanxi*. (Keller & Kronstedt, 2005, 61).

Rising labor costs and strengthening of RMB have made it more difficult to manufacture products in China and ship them to be sold overseas (Huang, Zhang, Liu 2013, 683). One of the findings of this thesis has been that a more worthwhile strategy is for Western supply chains to manufacture and sell their products in China. This is not an easy task, and establishing profitable business in China can take a long time. Forging the relationships and reputation needed to succeed is time-consuming and requires a lot of resources to be invested, but can result in successful business in a market that is both vast and expanding.

7.2 Research Limitations

The external validity or the generalizability of the conclusions of this study should also be examined (Yin, 2014, 48). This thesis examined six Finnish manufacturing companies and their supply chains, three large focal companies and three small focal companies. The utilization of multiple interviews should increase the external validity and generalizability of this thesis (Eisenhardt, 1989, 534). The companies operated on different industries, which can be seen both as a weakness and as a strength of this study. Despite having some differences in data and results that could be attributed to the differences in industry, the similarity of the results across different industries could be viewed as enhancing the ex-

ternal validity of this thesis. If the same phenomena is observed across different industries, it would suggest that the phenomena observed would in fact exist. Additionally the notion that much of the conclusions of this thesis have been supported by earlier literature would suggest that the results may be somewhat generalizable. Still, the generalizability of this research only extends to Finnish manufacturing companies operating in China, though with certain limitations. Even though the literature review and the analysis both supported the conclusions of this thesis, more research is needed to completely confirm the notions of how and why the business environment affects the resources and capabilities of companies operating in China. Being able to interview more companies and to interview them in more depth to increase the sample size and sample quality would have made the conclusions more externally valid.

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9 APPENDICES

Appendix 1, interview data codified

Large companies Institution	Resource	Capability	Description
Product Markets	Human Resources	Relationships	Products are sold through their technical qualities, rather than by solving an entire problem
Labor Markets	Human Resources		Labor markets are vast, finding good employees is hard, wage inflation 10% per year
Labor Market	Human Resources		Finding workers is easy, but as required technical skillset grows, so does the difficulty and price of employees
Labor Markets	Reputation, Human Resources		Underdeveloped labor markets have resulted in high employee-turnover rates
Openness			Good reputation helps in hiring the best candidates, employees must be managed effectively
Openness			On a very high level, Western ideas are seen as good and beneficial
Openness			As long as the new idea or thing is of use and utility to them, they are willing to change their behavior
Political and social system	Human Resources	Relationships	Towards Western ideas the Chinese are very curious and interested in all things new
Political and social system	Human Resources		Setting up a network of agents to create relationships instead of selling through distributors
Political and social system	Human Resources	Relationships	Human resources are the most important resource, but local culture must be understood, expatriates help
Political and social system	Human Resources, Organizational Resources	Relationships	Good long-term relationships with suppliers help keep supplier quality high
Political and social system	Human Resources, Organizational Resources	Relationships	Culture and language pose problems, training Westerners is infeasible, training locals the solution
Political and social system	Human Resources, Organizational Resources	Relationships	Good relationships with suppliers to easy doing business and sustain high quality
Political and social system	Organizational Resources	Innovation	Western managers have to adapt to Chinese culture to lead more effectively, best a compromise
Political and social system	Technological Resources	Relationships	Modifying existing technology rather than new innovations due to weak innovation capability in China
Political and social system	Technological Resources	Service, Quality	Good relationships prohibit copyright infringements
Political and social system			Selling service is hard, because if quality is good, why would you need service
Political and social system			Political system very different, but very much able to deal with any problems
Political and social system			Culture very authoritarian, emotions and feelings play an important role
Political and social system			Although the political system is relatively stable fast business cycle and local government deviations may cause problems
Political and social system		Relationships	Contracts often abided by, but not necessarily written on paper
Political and social system			Political system very stable, but anti-corruption laws make it very stiff
Political and social system		Quality	The culture is built around avoiding mistakes, which makes hiding them common
Product Markets	Organizational Resources	Flexibility	Developing project capabilities in order to better cope with rising demand with more flexibility
Product Markets	Organizational Resources	Cost, Relationships	Local suppliers help bring costs down and help facilitate localization
Product Markets	Organizational Resources		Fast and sporadic business cycle, Western slowness drives local managers crazy
Product Markets	Physical Resources	Delivery	Fast-paced markets require fast delivery from a local factory, which in some cases company E is not successful
Product Markets	Physical Resources	Flexibility	Volume flexibility the most common form of flexibility
Product Markets	Physical Resources	Delivery	Increases in production facilities to better serve customers
Product Markets	Physical Resources	Delivery	The importance of manufacturing in China is great and is growing in significance as time goes on
Product Markets	Physical Resources	Delivery	Specialized products manufactured in Europe, standard ones in China
Product Markets	Physical Resources, Organizational Resources	Delivery	Factory has to be in China due to lead times and fast business cycle, planning quite general
Product Markets	Technological Resources	Innovation	More important than new innovations is adjusting existing innovations to the Chinese markets

Large companies			
Institution	Resource	Capability	Description
Product Markets	Technological Resources	Innovations	Abandoning previous innovations and concentrating on modifying products to Chinese markets
Product Markets	Technological Resources	Quality	Quality is important; less competition and more willingness to pay, achieved through technology
Product Markets	Human Resources	Cost, Quality	Minority are able to buy expensive products, markets dominated by more affordable options
Product Markets	Human Resources	Quality	Fast business cycle renders life-cycle arguments useless
	Human Resources	Quality	Has been identified as important for success
	Human Resources	Relationships	Investments in human resources, training etc. Have been made to support high quality products
	Human Resources	Relationships	More localization, fewer expats, except for some top management located to China to create relationships
	Human Resources, Organizational Resources	Relationships	A sales organization was established to increase sales and better customer relationships
	Organizational Resources		Has been identified as important for success
	Organizational Resources, Physical Resources		Has been identified as important for success
	Organizational Resources, Physical Resources		Companies need to have manufacturing and management in China in order to succeed
	Physical Resources	Cost	Costs are an issue for Western companies, and have to be kept in line through better capacity utilization
	Reputation	Relationships	Reputation is important for customers and if lost, might seriously affect sales
	Reputation		Has been identified as important for success
	Technological Resources, Reputation		Technological resources are very important, which builds reputation, but innovations are done elsewhere
		Relationships	Most important capability, key to success
		Relationships	Has been identified as important for success
		Relationships	Very important, personnel, open doors and help retain customers
		Relationships	Top three most important capabilities, nothing exists without relationships, also to government
		Service	Top three most important capabilities, significance in China due to very international industry
		Quality	Top three most important capabilities

Small Companies		Resource	Capability	Description
Institution				
Product Markets	Reputation	Relationships	SMEs unknown in huge markets, so need to work hard to find a niche	
Capital and Financial Markets	Financial Resources	Relationships	Obtaining capital and regulations have been identified as difficulties	
Capital and Financial Markets	Human Resources	Service	Very different in many ways, harder for local SME's to raise capital	
Labor Markets	Human Resources	Relationships	Training of employees, SOPs for every position	
Labor Markets	Human Resources	Service	Recruiting managers with experience and IT & language skills is very difficult	
Labor Markets	Human Resources	Service	Finding capable engineers to be trained in technical consultation is difficult	
Labor Markets	Human Resources, Organizational Resources	Service	Labor markets vast but underdeveloped, employee turnover rates very high, SOPs	
Openness	Human Resources	Relationships	Very open to foreigners, development zones help foreign companies	
Openness	Human Resources	Relationships	Chinese authorities are very service-minded, cities compete on Western companies	
Political and social system	Human Resources	Relationships	Investments in relationships necessary	
Political and social system	Human Resources	Relationships	Good relations with suppliers help with suppliers keeping quality good	
Political and social system	Human Resources, Technological Resources	Innovation	Lack of knowledge in English and mentality differences make utilizing IT difficult	
Political and social system	Organizational Resources	Relationships	Culture affects way of thinking, which makes decision making intuitive	
Political and social system	Organizational Resources	Relationships	Different leaderships style in China, although Nordic model of leadership has been relatively successful	
Political and social system	Organizational Resources	Relationships	Different customs make managing a company very different in China, needs to be learned	
Political and social system	Organizational Resources	Relationships	Partnerships can be risky, as they can seem uneven in terms of investments	
Political and social system	Organizational Resources, Human Resources	Relationships	Project planning power has been increased through added personnel, better relationships as a result	
Political and social system	Reputation	Relationships	Reputation is important, other Western companies can help in creating good reputation	
Political and social system	Reputation	Relationships	State actor participation will bring good reputation and help in doing business	
Political and social system	Reputation	Innovation	In China innovation capability weak due to education system	
Political and social system	Reputation	Relationships	Communist party's aim to stay in power, policies not communist at all	
Political and social system	Reputation	Relationships	Contracts are based on trust, written contracts "just paper"	
Political and social system	Reputation	Relationships	Weak judicial system, which can be countered in higher courts, takes time and money	
Political and social system	Reputation	Relationships	Has been identified as important for success, personnel and important on many company levels	
Political and social system	Reputation	Quality	Strict government control, especially the anti-corruption campaigns may pose difficulties	
Political and social system	Reputation	Quality	Concept of quality differs from Western companies and is not necessarily uniform	
Political and social system	Reputation	Quality	More complicated than elsewhere, although not comparable to Russia	
Product Markets	Organizational Resources	Relationships	Copyright infringements force companies to divide systems to multiple suppliers	
Product Markets	Organizational Resources	Relationships	Extremely fast business cycle forces companies to more intuitive decision making	
Product Markets	Organizational Resources	Relationships	Market for products does not yet exist so partnerships with Western companies to create a market	
Product Markets	Physical Resources	Cost	In order to bring costs down in fierce competition a production facility was established	
Product Markets	Physical Resources	Delivery	"if you are going to sell in China, you have to make it in China"	

Small Companies Institution	Resource	Capability	Description
Product Markets	Technological Resources	Flexibility	Industry standards differ from other markets, many local standards
Product Markets	Human Resources	Delivery, Flexibility	Customers expect a lot of volume flexibility
Product Markets	Human Resources	Flexibility	Extremely fast business cycle, up and downturns in demand affects business
Product Markets	Human Resources	Innovation	Rapid growth and fast business cycle pose a new dynamic to doing business
	Human Resources	Quality	Volume flexibility easy due to employee willingness to overtime
	Human Resources, Technological Resources	Cost, Delivery	Has been identified as important for success
	Physical Resources	Delivery, Flexibility	Expatriate managers are important, "watchdogs"
	Physical Resources	Delivery	Expatriates are important in bringing competencies and technical knowledge to companies
	Physical Resources	Service	Weak understanding of blueprints and lack of documentation has made technology transfer difficult
	Reputation	Quality	Investments to production to bring down costs and to be able to provide larger volumes
	Technological Resources	Relationships	Investments in logistics capabilities were made
	Technological Resources, Human Resources	Cost	Physical resources need to exist in China, otherwise lead times are too long
		Quality	Has been identified as important for success
		Relationships	Has been identified as important for success
		Cost	In order for companies to have something to sell, they need innovations, connected to know-how
		Quality	Has been identified as important for success
		Relationships	Has been identified as important for success
		Cost	Has been identified as important for success, guanxi relationships
		Quality	Cost-adjustments were made in order to stay competitive
		Relationships	Self-evident in importance, especially true when problems arise
			Has been identified as important for success

Appendix 2, the interview questionnaire

Questionnaire for a theme interview

Name:	Company:
Position:	Industry:
E-mail:	Turnover:
Time and Date:	Number of employees:

Please describe your core business in China.

- Who are your customers? What does your supply chain look like?
- What are the reasons why the customers buy your products or services? What are your **order-winning factors**?

What **capabilities** are critical to your company doing business in China? Examples of capabilities are provided below:

Cost

Quality

Flexibility

Innovation

Service

Delivery (speed, reliability, coverage, and logistics capabilities)

Relationships (both to customers and suppliers, marketing and advertisement)

What **resources** are critical to your company being able to provide these capabilities?

Examples of resources are provided below:

- **Financial Resources**
- **Physical Resources**
- **Human Resources**
- **Technological Resources**
- **Reputation**
- **Organizational Resources**

Please describe the **business environment** in China especially relating to the following facets:

- **Political System** - both formal and informal
- **Social System** - customs, traditions, behavior etc.
- **Capital and Financial Markets** – how easy is it to acquire capital
- **Openness** to new ideas - are there major restrictions for foreign companies when it comes to ownership, location, logistics and other factors?
- **Product markets** - what is it like to operate as a buyer or as a seller? Are there databases regarding customer segments, their credit ratings and other business intelligence?
- **Labor markets** – how hard is it to recruit talented employees, retain them, and have the employees work effectively? How is the work related legislation?

How does the **business environment** affect your doing business in China.

What changes have been made in the **resources** your company utilizes?

What changes have been made in the **capabilities** your company utilizes?

What have you **learned** from doing business in China?

Thank you very much for your participation!