

International Business
Master Thesis No 2003:47

**INTERNATIONAL SOURCING
IN EMERGING MARKETS**

-

**A CASE STUDY OF ICA NON-FOOD
IN CHINA AND LATVIA**

Susanne Holmström & Maria Karlsson

Graduate Business School
School of Economics and Commercial Law
Göteborg University
ISSN 1403-851X
Printed by Elanders Novum

ABSTRACT

Global sourcing is becoming increasingly important, and is currently a top priority by many firms. The increased globalisation and the dynamic environment, like the EU Enlargement and Chinas' membership in the WTO, makes the sourcing process complex but it also generates opportunities of creating a competitive advantage in sourcing strategy. WTO is changing the trade pattern and influencing the sourcing decision.

Within the retailing industry purchasing has always been a priority but the increasing numbers of private labels makes the sourcing activities even more important.

This study investigates how retailing companies should conduct and balance their sourcing activities in order to respond to new operating conditions and utilize the dynamics of emerging markets.

A case study of ICA Non-Food is conducted with focus on the Home Textile department. The study provides a proposal of how sourcing activities within home textiles can be balanced in China and Latvia, two markets with differing competitive advantages.

A Supplier Selection Model is developed, which shows important stages in the sourcing process and analyses the product characteristics, supplier relationships and the risks and opportunities of the markets.

The conclusions can be applied to the retailing industry, and will show the importance of a balanced sourcing and how and why a main sourcing market like China can preferably be complemented by a market like Latvia.

Key words; International Sourcing, Sourcing Strategies, Retailing, China, Latvia, Textile Industry, Supplier Selection Model

ACKNOWLEDGEMENT

This thesis has been enabled by a close cooperation between the Graduate Business School at Göteborg University and ICA AB. Without the help from these two institutions this research could not have been conducted.

We would firstly like to express our gratitude to Professor Claes-Göran Alvstam and Professor Jan-Erik Vahlne for their support and guidance during the research process. Many valuable thoughts and ideas have been developed during our discussions and we appreciated the experience and advices the Professors have provided in the subject matter.

We would further like to express our appreciation to ICA AB for the great support that we have received during the research period. Special recognition must be given to Erik Törnqvist, Category Director at ICA Non-Food AB, who supported our initial research idea and has given valuable contribution and support during the research process. We would also like to express our gratitude to Christina Erikson, Product Manager for Home Textiles at ICA Non-Food AB. She has shared her knowledge of retailing and home textiles, throughout the research period and her help has been of utmost importance.

Finally, we would like to thank all interviewee who has taken their time to meet with us. No names will be mentioned, but every interview conducted has been of great importance as it has increased our knowledge and understanding of our research problem.

Gothenburg, 5th of December 2003

Susanne Holmström & Maria Karlsson

1	INTRODUCTION.....	1
1.1	BACKGROUND.....	1
1.2	PROBLEM DISCUSSION.....	2
1.3	PROBLEM FORMULATION.....	3
1.4	PURPOSE.....	4
1.5	DELIMITATIONS.....	5
1.5.1	<i>Case Company and Unit Selection.....</i>	5
1.5.2	<i>Geographical Selections.....</i>	5
1.5.3	<i>Research Delimitations.....</i>	7
1.6	DISPOSITION.....	8
2	METHODOLOGY.....	9
2.1	RESEARCH APPROACH.....	9
2.2	RESEARCH METHOD.....	11
2.3	CASE STUDY APPROACH.....	12
2.4	SCENARIO PLANNING.....	15
2.5	VALIDITY AND RELIABILITY.....	16
2.5.1	<i>Internal Validity – Truthfulness.....</i>	17
2.5.2	<i>Critical Review of Internal Validity.....</i>	18
2.5.3	<i>Reliability.....</i>	18
2.5.4	<i>External Validity.....</i>	19
3	THEORY.....	21
3.1	SOURCING; AN INTEGRAL PART OF THE VALUE CHAIN.....	21
3.2	SOURCING EVOLUTION AND INTERNATIONALISATION.....	23
3.2.1	<i>Food Retailing Sourcing.....</i>	28
3.3	SUPPLIER RELATIONSHIPS.....	29
3.3.1	<i>Low Involvement Relationships.....</i>	30
3.3.2	<i>High Involvement Relationships.....</i>	31
3.4	MODEL FOR RETAIL SOURCING.....	31
3.5	THEORY REFLECTION.....	34
4	SWEDISH RETAILING AND EMERGING MARKETS.....	37
4.1	NEW IMPERATIVES IN THE RETAILING INDUSTRY.....	37
4.1.1	<i>Swedish Food-retailing Industry.....</i>	38
4.1.2	<i>ICA.....</i>	39
4.1.3	<i>ICA Non-Food.....</i>	44
4.1.4	<i>Product Group – Home textiles.....</i>	49
4.1.5	<i>The Global Textile Industry.....</i>	52
4.2	CHINA.....	59
4.2.1	<i>Political Situation.....</i>	59
4.2.2	<i>Economical Aspects.....</i>	64
4.2.3	<i>Industry Development.....</i>	69
4.2.4	<i>Future Development of China.....</i>	76
4.3	LATVIA.....	82
4.3.1	<i>Political Situation.....</i>	82
4.3.2	<i>Economic Aspects.....</i>	86

4.3.3	<i>Industry Development</i>	91
4.3.4	<i>Future Development of Latvia</i>	97
4.4	SWEDISH INTEREST IN CHINA AND LATVIA	103
5	SUPPLIER SELECTION ANALYSIS.....	105
5.1	PRODUCT ANALYSIS.....	107
5.1.1	<i>Product Assortment</i>	107
5.1.2	<i>Product Type</i>	108
5.1.3	<i>Product Attributes</i>	108
5.2	SUPPLIER RELATIONSHIP ANALYSIS.....	109
5.3	CRITERIA ANALYSIS.....	110
5.3.1	<i>Financial Aspects</i>	111
5.3.2	<i>Trade Restrictions</i>	114
5.3.3	<i>Perceived Risk</i>	116
5.3.4	<i>Quality Assurance</i>	120
5.3.5	<i>Service Performance</i>	122
5.3.6	<i>Buyer-Supplier Relationship</i>	124
5.3.7	<i>Cultural Barriers</i>	126
5.3.8	<i>Result of Supplier Selection Process</i>	128
6	RECOMMENDATIONS.....	133
6.1	SUPPLIER SELECTION MODEL – BED SETS AND SHEETS	133
6.2	RECOMMENDATIONS ON PRODUCT GROUP LEVEL	134
6.3	SPECIFIC RECOMMENDATIONS TO HOME TEXTILES	138
6.4	RECOMMENDATIONS ON STRATEGIC LEVEL.....	139
7	CONCLUSIONS	143
7.1	SUGGESTIONS FOR FURTHER RESEARCH	146
8	REFERENCE LIST	149
9	APPENDIX.....	161

Table of Figures

Figure 1; Disposition of the Thesis	8
Figure 2; Research Approach.....	10
Figure 3, Research Method.....	11
Figure 4; Retail Value-Chain.....	22
Figure 5; Modified Highlights of Retail Value-chain	23
Figure 6; Firms' Sourcing Capabilities	24
Figure 7; International Supplier Selection.....	27
Figure 8, Modified Model of Supplier Selection Process	32
Figure 9; ICA AB Organisational Charts	40
Figure 10; Modified Picture of ICA Product Assortment	41
Figure 11; Division of ICA Own Labels	45
Figure 12; ICA Non-Food Imports per Country of Origin - Monetary terms.....	46
Figure 13; ICA Non-Food Import from China and Hong Kong 2002 - Monetary terms.....	46
Figure 14; Home textiles per Country of Origin - Monetary terms	51
Figure 15; China Income Distribution 1998.....	66
Figure 16; China Consumer Price Index 97-02.....	67
Figure 17; Exchange Rate Fluctuations RMB/€and RMB/SEK,	68
Figure 18; Average Monthly Wages in China.....	73
Figure 19; Latvia Income Distribution 1998	88
Figure 20; Consumer Price Index 97-02	89
Figure 21; Exchange Rate Fluctuations Lat/€and Lat/SEK,	90
Figure 22; Average Monthly Wages in Latvia	95
Figure 23; Swedish Imports from China & HK	103
Figure 24; Swedish Imports from Latvia	103
Figure 25; Modified Model of Supplier Selection Process	105
Figure 26; SWOT Analysis of China in Sourcing Perspective	128
Figure 27; SWOT Analysis of Latvia in Sourcing Perspective.....	129

1 INTRODUCTION

*“A great wind is blowing, and that gives you
either imagination or a headache.”*

- Catherine the Great

1.1 Background

Literature and reports continuously discuss topics regarding globalisation, changing business environment and transformation to the IT society. However, the basic notion of business is still the same as it has been throughout history; “create positive value for the customers”, but the means of achievement has changed dramatically. The importance of international or global sourcing has recently been recognised and has lately been a top priority for many firms. In today’s competitive environment it is important to purchase the right goods, for direct resale or input material and to consider the right price, right quality and right place with both internal as well as external factors influencing the sourcing decisions. The challenge for companies is to develop a successful multiple sourcing strategy, taking into consideration competitive advantages of nations in a global and dynamic environment. This process takes different structure in different industries depending on the aim and goal of the sourcing activities and the use of the products.¹

In the retailing industry, sourcing strategies are of utmost importance in order to stay competitive. In recent times the downstream activities of the value chain have been more emphasised whereof the purchasing process has been identified as a key driver to profit maximisation. In addition, along with the growth of grocery retailers, the development of private brands and labels has sequentially been increasing, raising the margins for the retailers. As a consequence of the development of private labels, retailers exclude several steps in the purchasing process, and are nowadays in business directly with the producers and factories. By creating effective sourcing and product strategies large opportunities prevails to enhance firms operating margins, but it puts new requirements on the firms’ sourcing strategies and a closer relationship between the firm and its suppliers. The retailers need to continuously search for potential suppliers on the global field, taking both external and internal factors into consideration. The globalisation and regionalisation process are creating a dynamic and

¹ Nolan Alexis, (1999)

turbulent situation, which pose a challenge to firms to adapt and take advantage of this situation.

Today the world is experiencing the emergence of a new superpower when it comes to sourcing and purchasing; China. Due to its vast resources, especially in regards to the abundance of labour, China is dominating the world export of manufactured goods and is also quickly enhancing into other sectors. As China recently entered the World Trade Organisation (WTO) changes in the political and economical structure as well as in the trade regulation can be expected which will further enhance trade. However, it is not only in the Far East changes on the global map are occurring in regards to economical and political transition. The upcoming enlargement of the European Union will lead to a historical enhancement of the EU. As of May 2004 the Single Internal Market will include ten new member countries and amount to 500 million consumers. The Accession Countries from Eastern Europe are transitional economies with competitive advantage of low production costs in an EU perspective, which will further open up possibilities for sourcing by Swedish companies in these countries. Two milestones in the world economy have and will occur, the China WTO membership and the EU enlargement, and these changes can and will affect firms' pattern of sourcing activities.

1.2 Problem Discussion

The changing global environment raises many important questions regarding sourcing activities undertaken by retailing firms. New innovative solutions must be reached in order for firms to exploit opportunities in the global market as well as respond to forces of intensified competition. Effective sourcing solutions are the competitive weapon of many retailers today. Rational economic arguments, with price minimisation in focus, must today be complemented with non-financial aspects as sourcing is becoming a global rather than domestic affair. Globalisation drivers are enabling retailers to exploit markets previously sheltered, hence large opportunities prevail in cost reduction, though at the expense of accepting higher level of risk. As a reactive approach regionalisation forces such as the EU-enlargement is occurring creating indirect trade barriers as well as incentives to locate production within the home market, i.e. Single Internal Market. The two opposing developments create a complex situation for firms searching for the optimal sourcing solution.

Many factors are occurring within the retailing business and new operating environments are forcing firms to be reactive and forward thinking in all areas of operations. The intensified competition, enhanced internationalisation of retailers and the increasing number of food-retailers require new strategies and solutions. One of many is the further development of private labels, which dramatically alter firm's profit margins, and opens up opportunities for differentiation. It is a solution to many problems; nevertheless, it directly positions the retailer for the next coming problem of how and where these products ought to be sourced.

As firms are realising the potential as well as the complexity within sourcing more emphasis is being put towards creating a sustainable sourcing strategy in a dynamic world. Cost minimization must be balanced against risk reduction and this in conjunction with intensified competition. The dynamic global environment constantly changes the competitive advantages of nations, which thereby alters the pattern of trade. Taking these factors into consideration, one may question how a retailing company can best utilize the competitive advantages of different markets when selecting suppliers in order to create a balanced sourcing strategy.

1.3 Problem Formulation

How should retailing companies conduct and balance their sourcing activities in order to respond to new operating conditions and utilise the dynamics of emerging markets?

The problem formulation pinpoints the important question of how retailers ought to structure their sourcing activities in order to create competitive advantage by targeting the potentials of different markets, and combine these in order to create a comprehensive sourcing strategy. In a dynamic market, where risk and return is closely connected, balancing of sourcing becomes increasingly important. Different countries and suppliers provide diverse competitive advantages in relation to quantitative versus qualitative factors, i.e. low-cost versus reduced risk and increased flexibility, thereby different sourcing solutions can be offered. Retailers are starting to understand the need to approach sourcing in a holistic perspective, encompassing both financial and

non-financial variables and put this in conjunction with firm-specific attribute such as overall strategy, product assortment and consumer profile. Screening of possible sourcing markets and analysis of potential suppliers are of utmost importance in order to adapt to the changes occurring and to exploit the opportunities prevailing. Still retailers must take into consideration; reduced cost on the behalf of potential enhanced risk.

To answer the problem formulation above, a case study of the largest food retailer in Sweden ICA AB will be conducted. The study will investigate the sourcing potential of emerging markets, in this case China and Latvia. These are nations with different market characteristics and attributes, though both are experiencing dynamic external pressures as China recently entered the World Trade Organisation (WTO), i.e. globalisation driver, and Latvia is about to join the European Union (EU) in 2004, i.e. regionalisation driver. It is therefore of great interest to research the potential competitive advantages of sourcing that remains within these two different countries. To further investigate how product characteristics influence the selection of sourcing market a further investigation of the Home Textile product group within ICA Non-Food will be conducted.

1.4 Purpose

The purpose of this study is to investigate how external and internal changes affect retailers' sourcing activities in emerging markets, and subsequently present how these sourcing activities can be conducted.

Furthermore, the aim is to provide theoretical guidelines of how to analyse potential markets when conducting global sourcing within the retailing industry. The idea is to move outside the circle of traditional sourcing, and look beyond pure financial decisions in order to investigate how a retailing company can form a competitive sourcing strategy, using ICA Non-Food as a case example.

1.5 Delimitations

The research area takes a rather broad approach and views international sourcing activities from a holistic perspective, taking many aspects into consideration. Therefore, it is of utmost importance to make distinctive and clear-cut delimitations in order to increase the accuracy as well as validity of the report. The delimitations are combined with the aspects of case study selections as these are interrelated. The delimitation is divided into three different aspects including case company selection, geographical selection and other research delimitation.

1.5.1 Case Company and Unit Selection

A case study of ICA will be conducted in order to answer the problem formulation. ICA is the leading food-retailer on the Swedish market and can be stated to represent a retailing company operating internationally. To further support the findings, and to increase the validity of the report, an in-depth research of the Home Textile department is conducted. The selection of Home Textile as product group was a natural decision as ICA is today rethinking the sourcing markets for certain articles within this product group. Furthermore, home textile, along with clothing, is an industry sector surrounded by extensive protectionism taken form of quotas and tariffs, which increases the incitement of analysing the product area thoroughly. The EU Enlargement and the recent Chinese membership in the World Trade Organisation (WTO) along with the phase out of the Multi Fibre Agreement will greatly affect this product group, and it is therefore interesting to study in a future perspective.

1.5.2 Geographical Selections

The scope of the research is to investigate the sourcing potential for retailing goods in the emerging markets of Eastern Europe and China, and how these two markets can complement each other to offer a good sourcing combination. Although, as the scope is quite extensive, the need for geographical delimitations is apparent. The choice of China was evident because of its immense size, increasing imports from China by ICA and its recent WTO accession. Though, it must be stated that during the research process it was identified that the most important market for home textiles was India, not China. This put the research process in a difficult situation, as the case study had its emphasis on home textiles. However, it is believed that this is dealt successfully with by using the “Modified Supplier Selection Model” thus

applying the reasoning about sourcing to other Asian countries. In addition, China resides future potential within the textile sector and will pose a threat to India if it does not increase its competitiveness. The choice of China was also motivated by the interest of ICA and ICA Non-Foods in sourcing activities in China, and to be able to draw wider conclusion including other product groups than home textile, for example clothing, the investigation of China as sourcing market was encouraged.

The study of China will not be delimited in geographical scope, though much research derive from the two most developed areas; City of Shanghai and Guangdong province. Due to the extensiveness of ICA Non-Food's product range it is not possible to choose a certain district or industrial clusters in China, rather it is important to take an overall perspective and investigate potential of different areas of China. This decision is taken, as the research will conclude with forecasts of the two markets as well as forthcoming potential product groups.

When surveying Eastern Europe the issue of delimitations is more complex. Even though the region is geographically smaller than China the disparity between the nations is very apparent. The political, economical and industrial policies vary and thereby make it impossible to view the region as a whole. Consequently, this study will focus on only one "case" nation, Latvia, and will finally be followed by a discussion of the applicability of Latvia to the whole region. The motives supporting the choice of Latvia as the case nation is based on a number of reasons. Latvia is one of the more interesting regions within Eastern Europe when it comes to home textiles, which is the product group from which future predictions will be made. Also macro economic indicators like, wage levels, factor costs and GDP level further support that Latvia is an interesting market in terms of labour intensive production as it is among the lowest of the accession countries. Due to Latvia's favourable geographical location, close to Sweden as well as the CIS countries, Latvia can also be used as a statutory example before entering countries such as Ukraine, Belarus and other CIS countries. There is also an outspoken interest by ICA Non-Food to investigate the potential to further develop its sourcing activities in the region.

1.5.3 Research Delimitations

The thesis will provide the reader with information of the macro and microenvironment of the two nations researched. However, these indications will focus on areas of interest for sourcing activities and the non-food sector, and will leave out otherwise important aspects when conducting an analysis of environment conditions. The empirical chapter will focus on political, economical and industrial aspects of importance in this research and leave out some macro and microeconomic and political pointers that can be considered vital in other research areas, for example market penetration or expansion.

A second aspect of importance when analysing the two markets of Latvia and China is that the analysis takes a complementary focus rather than a comparative approach. The difference between Latvia and China in central aspects like economy, culture and above all, market size is immense and the study makes no attempt to compare these aspects to each other. The intent in this study is to investigate the competitive advantages of the two nations and how these can be utilised by ICA Non-Food.

The problem formulation takes no geographical delimitation and a wide perspective is applied, which comprise retailing and retailers in an international perspective. The reason behind this is the applicability of the study to other regions of the world where the same reasoning of balanced sourcing is conducted. In the text, the case study is of ICA Non-Food and therefore takes a Swedish perspective, and discussions are made on the basis of Latvia being a geographically close market and China a distant emerging market. The study will not further investigate other regions but the reasoning and the theoretical foundation could be used in other research, i.e. if applied on the United States, Mexico could represent Latvia and China would still be the distant emerging market.

1.6 Disposition

The disposition of the Thesis is visualised by the image below, which gives a picture of the sequential presentation of information. The empirical chapter “Swedish Retailing and Emerging Markets” is divided into three different aspects and provide background information that is later connected in the analytical chapter of “Supplier Selection Analysis”. This is followed by a chapter of recommendations to ICA Non-Food and the Home Textile department and Conclusion reflecting on the overall problem formulation.

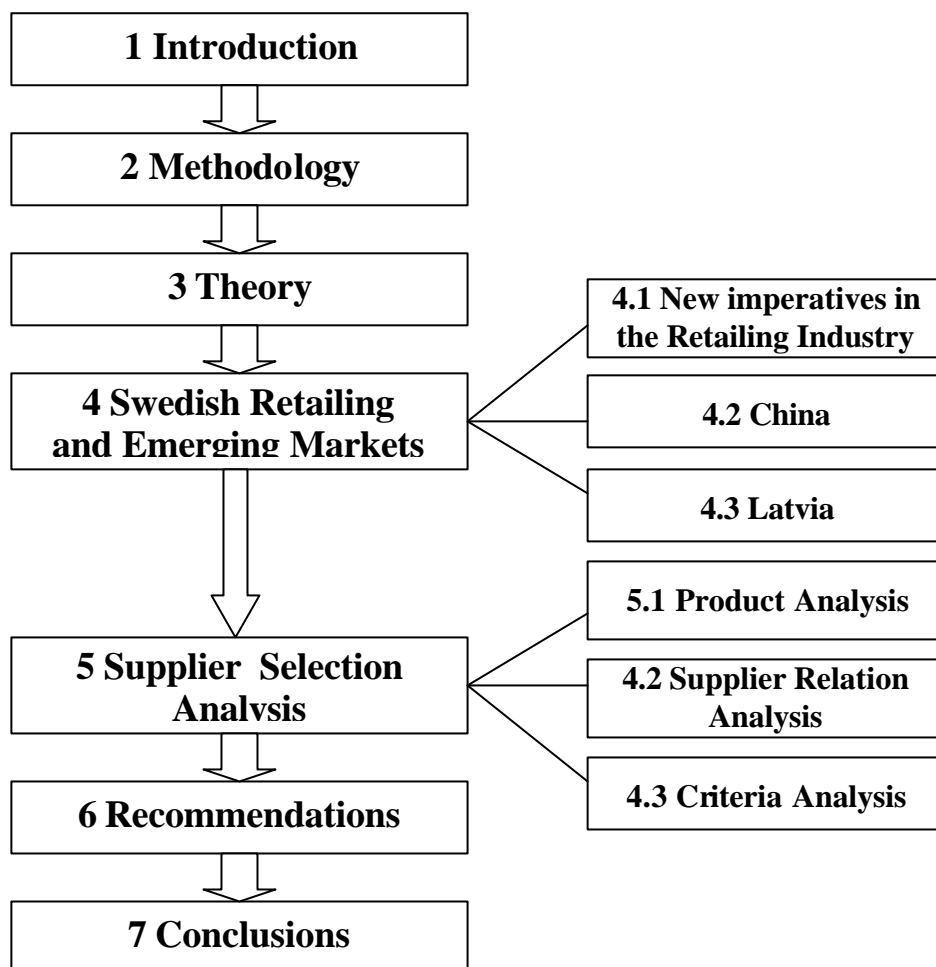


Figure 1; Disposition of the Thesis

2 METHODOLOGY

The methodological chapter will provide an understanding of the research process. It will give an indication of the authors' own perception of, as well as approach to, the research problem. Furthermore, it will provide incitements to establish the truthfulness of the investigation. The chapter will present the traditional aspects of research approaches and methods combined with a discussion of the reliability and validity of the research. It will furthermore explain the research process and the development of the relevant problem formulation and problem area.

2.1 Research Approach

It is important to describe and analyse the authors' approach in the research process in order to understand how the end result has been achieved. This study is based on an abductive research approach, combining both inductive and deductive thinking. The deductive approach is based on general principles and existing theories from which researchers draw conclusions. By having an existing theory, this determines what information should be gathered, how this ought to be interpreted and sequentially be related to the already existing theory. A inductive approach is the counterpart to a deductive approach. If the researchers are using an inductive approach, it can be said that he or she is following the path of discovery. The researchers are studying the object of research and from the information collected they formulate a theory.²

The study conducted in this research is based on a combination of theory building and empirical research in a continuous process throughout the research procedure. The starting point of the research was based on a presumption that the upcoming EU enlargement and WTO extension would affect the global trade relations with the consequence of an integration of trade within EU's Single market. This assumption has been modified during the preliminary research as the authors have gained increased understanding of the undertaken subject as well as engaged in discussions with supervising professors regarding delimitations required. Research has been conducted in different steps and manners based on studies on both country level and case company level. The empirical findings and interpretations have always been followed by

² Patel R. & Davidson B. (1994)

modification and reflection of the theoretical framework leading to adaptations in the basic theoretical structure. The theoretical study has also helped to widen and enhance the empirical study by identifying new concerns to empirically consider. The research process can be visualised by the following picture.

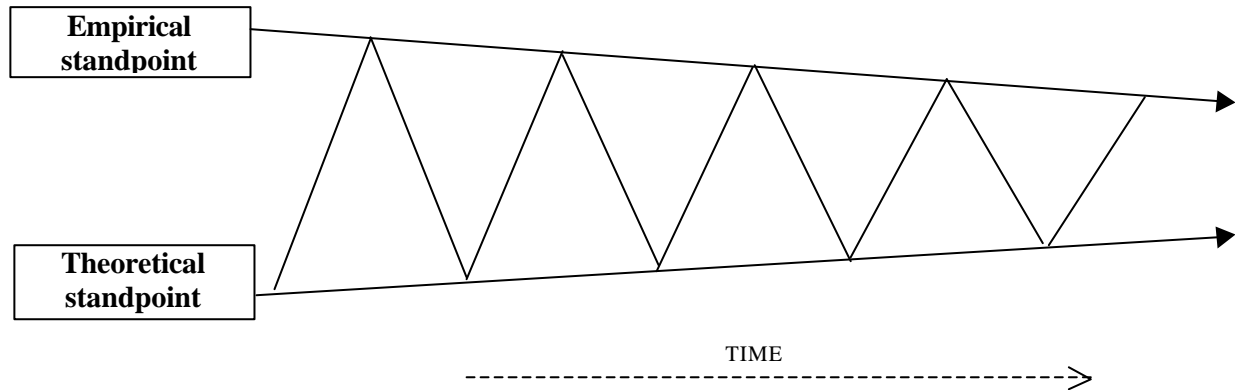


Figure 2; Research Approach

The study takes an abductive approach as the picture shows. It started with a wide perspective, enabling the authors to view the process in conjunction with its external environment, and subsequently pinpoint the most important aspects of the undertaken subject for further research. This research aimed to grasp the complexity of real life problems and combine them with theoretical rationale to gain thorough understanding of retailing, case markets and sourcing activities. Several events have throughout the research process initiated the re-evaluation process of the theoretical framework as well as validity and relevance of the empirical data. The two most important events were the field trips in Latvia and China, where the initial theories and empirical knowledge was tested and later on revised. Complimentary research in the home market along with interviews furthermore motivated to continuous updates of the research process. A final revision of the theoretical foundation took place during the final week of the research. The model developed by the authors, “Modified Supplier Selection, see chapter 3.4, aimed to attached a weighted importance to each specified criteria in the model to support the selection of supplier and market. Though, as the reality is dynamic, the relative importance changes in accordance to its context, hence no generalisations could be made based on discussion with Product Mangers at ICA Non-Food. As a result, the model presented in the theoretical chapter (Chapter 3.4) will be used as an analytical tool combined with our theoretical framework. The process of continuous revision of the research approach has led the authors to find the aspects of interest to focus on in the following thesis, which is further supported when discussing the research perspective in the study.

2.2 Research Method

The research method refers to the technique by which data has been collected and evaluated. Usually researchers decide on either a qualitative or a quantitative method depending on the collection of primary data, i.e. interviews and questionnaires. Put in simple terms quantitative methods involve numbers and statistical data while qualitative research is more focused on auditory data collection like interviews. However, it is important to consider both aspects when deciding upon research method. Qualitative and quantitative measures can advantageously be combined in the same research to provide an increased understanding as well as validity of the report. As this research has been conducted using a case study approach, the qualitative mode such as interviews, articles and reports and field study impressions have laid the foundation for the empirical data and analysis. However, these findings and statements are further supported by qualitative data such as country statistics as well as ICA Non-Foods sales and import figures. The research undertaken could not be conducted without the combination of personal interpretations of qualitative data and historical statistics. As shown in the picture below the connection between qualitative and quantitative studies is straightforward and it is clear that one research approach does not necessary exclude the other.



Figure 3; Research Method

Source; Patel R. & Davidson B. (1994)

Qualitative methods permit the scientist to study selected issues in depth without any structural constraints. Field studies, as performed in this research, were conducted without any restraints of predetermined categories of analysis, which contribute to depth and openness and in qualitative inquiries. Personal interviews with open-ended questions were conducted and the emphasis was to learn from each interviewee's perception of the research problem as well as confirm previous findings in order to enhance the understanding.³

³ Patel R. & Davidson B. (1994)

Qualitative research has often been considered as a contrast to traditional research. In traditional research the basic reasoning is supported by the belief that the reality is objective and is possible to study.⁴ The qualitative approach states that there are several realities and that the reality is based on functions and connections between people and situations and the understanding that evolves within. As two field studies have been conducted, the authors have in conjunction with deskwork experienced the reality that is believed to be studied. This has given enhanced understanding of the problem as well as addressed new issues of concern. Though, it must be stated that the authors during the field trips were sheltered from parts of the reality as visits were made to Guanzhou, Shanghai, Hangzhou and Riga which all are developed cities compared to national average.

The qualitative approach requires a close and durable contact with the studied group or community in its natural environment. The aim is to narrow the gap between the observer and the observed, i.e. the authors and ICA Non-Food AB.⁵ The relation between the authors and ICA Non-Food that represent the case company has been very rewarding. Since most of the research process has been conducted in the office space of ICA Non-Food, the authors has gained inside information of the organisational culture as well as daily operations. Likewise, the personnel at ICA Non-Food has gained an understanding of the research problem and shared their thoughts and experiences with the authors in order to create an outcome inline with ICA Non-Food's reality.

2.3 Case Study Approach

To investigate the problem area, a case study of ICA Non-Food, China and Latvia is conducted. The case study approach, as an academic research, is widely used but there are diverse opinions about what the concept implies. It is stated that a case study is preferable to use in studies of a present phenomenon and in a situation where it is not possible to manipulate relevant variables like it is in a quantitative approach. The strength of a case study approach is that it is possible to handle several different types of empirical material like documents, artefact, interviews and observations.⁶ As this research has the overall aim to answer a broad and complex problem formulation,

⁴ Merriam, Sharam B. (1988)

⁵ Sköldbberg, Kaj & Alveson, Mats (1994)

⁶ Merriam, Sharam B. (1988)

“How should retailing companies conduct and balance their sourcing activities in order to respond to new operating conditions and utilize the dynamics of emerging markets?”, conclusions will be reached by quantitative and quantitative research of ICA Non-Food in parallel with China and Latvia.

A case study approach is preferable if the knowledge obtained is in connection with the current reality and the authors' own experiences. The knowledge is direct, living and concrete in comparison with other scientific knowledge.⁷ Cronbach introduced the expression of “interpretation in context”⁸ which can be applicable in this research, as the case study of ICA Non-Food has enabled us to be present at the company throughout the research problem as well as in China and Latvia. This is important, as it has enabled the authors to concentrate on a single situation or occasion and view this situation or occasion in a wider context, i.e. the Home Textile department and its sourcing strategies.⁹

The end result of a case study is descriptive and interpretation of the data ought to be put in a demographic context. To support the descriptive characteristics of the case study one can point out the complexity of the situation. This is further illustrated by the fact that data collection must be gathered by different sources. The case study can be stated to have a particularistic nature as it shows the reader what should be done in the specific case with ICA Non-Food, and not what should be done in a similar situation by other retailers, i.e. the case study concerns a particular situation but can point out a general problem.¹⁰ A case study as conducted in this thesis is longitudinal, this is why case studies can be called holistic, empirically grounded and explorative. The study undertaken in this thesis is of encompassing nature and empirically supported with aim of finding new solutions to existing problems. Generalisations are created based on the information that the authors have gathered and further interpreted to the context that serves as the foundation from which the problem is studied.¹¹ By using ICA Non-Food as a case company, the aim is to make general assumption of how retailers ought to conduct their sourcing strategies.

⁷ Merriam, Sharam B. (1988)

⁸ Cronbach L J (1975)

⁹ Merriam, Sharam B. (1988)

¹⁰ *ibid.*

¹¹ *ibid.*

The case study can be divided into three different levels representing separate cases in the main case study. The following division explains the reasoning.

Case Company - ICA Non-Food

By conducting a case study of ICA Non-Food, parallels can be drawn to the Swedish retailing industry in general as ICA represent one of the largest retailing companies on the Swedish market. By further investigating the non-food division, it can be applicable to several other retailers, domestic and international.

Case markets; China & Latvia

The aim of the research is to investigate the complexity and sourcing potential of emerging markets. To be able to perform an in-depth study of the diverse characteristics of different emerging markets, China and Latvia will exemplify the two markets of Asia and Eastern Europe. An in-depth study of the two mentioned markets will show the current and future potential for purchasing activities in the respective market and how external factors like EU enlargement and WTO regulation affect the sourcing decision. The aim is to see how these two regions, with different competitive advantages, can be used in sourcing activities performed by Swedish retailers.

Case product group; Home textiles

An in-depth study of one product group within the non-food sector, the Home Textile department, will be conducted. This will be followed by a discussion of applicability to the overall assortment of ICA Non-Food. The study will show the characteristics of home textiles as a product group and how these characteristics can be match and best sourced in regards to the distinctiveness of the Chinese and Latvian market.

As presented in the model above, the case study of ICA will be divided into three interrelated subsections in order to answer to the overall research problem. As described in the delimitation chapter the case study in this research is stated to represent a steady and reliable picture of the problem area and holistically view of the company, product group and markets. However, a major concern in the research process was how to present and predict the future potential of the sourcing markets.

2.4 Scenario Planning

In the volatile global environment of today, companies are becoming more interested in understanding the environmental forces. Today the business environment is complex, discontinuous and turbulent. Scenario planning has an over-riding goal to and an underlying mind-set to help companies confront the threatening challenges and render themselves efficiently adaptive.¹²

The scenarios and forecasts used in this thesis are based on a qualitative approach and it is not supported by computerised scenario planning tools. There are four modes of scenario planning according to Georgantzas and Acar (1995). The first mode, inactivity, involves ignoring the changes and continuing business as usual. The second mode, reactivity, involves waiting for something to happen and consequentially respond to that change; here the response has to be stimulated by an outer force. The third mode is pre-active and involves trying to predict external changes and positioning the firm before this happens. This pre-active mode is preventative. The fourth mode called pro-active or interactive mode, which calls for an interactive involvement with the outer forces and pressures that seek to create the future for a firm stakeholder groups.¹³

In the case study of this thesis, the pre-active mode is used in order to gain an understanding of the future scenarios for the emerging markets of China and Latvia. Section 4.2 and 4.3 will discuss the characteristics of the Chinese and Latvian markets, and both chapters will be finalised by scenarios of the markets. The scenarios will take into consideration the dynamic circumstances occurring within the nation in conjunction with external global forces pressuring for responsiveness. The scenarios state a basic attitude for the changes taken place in the environment.¹⁴

The research conducted in this study leading up to the scenarios is focusing on the current and future potentials for sourcing activates in the two researched markets; China and Latvia. The scenarios do not strive to compare the two nations in order to find the best sourcing market; rather establish the authors' view of the future development within the two markets in a sourcing

¹² Georghantzas, Nicholas V. & Acar, William (1995)

¹³ *ibid.*

¹⁴ *ibid.*

perspective as well as highlight the dynamics within the markets. It is important to highlight the unevenness between the two markets, Latvia has a population of less than 1/6 of the City of Shanghai, hence their resources and capabilities differ dramatically. However, the future of the two markets is uncertain with numerous opportunities and threats as both China and Latvia are considered to be emerging markets, hence forecasting and scenario planning is of highest importance. This considered, a three level scenario is applied to give a picture of how the development of the markets can cultivate in three different altitudes; best scenario, most likely scenario and worst-case scenario.

It is also important to consider the progression of the events that lead to the scenario presented and to point out the theoretical aim with the scenarios. There are two main categories; “situational scenarios/images” that describe future situations and the “development scenario” which describe the sequence of events that lead to the outcomes. In this thesis the first mode will be handled as the scenarios will take into consideration the pace of development in political, economical and industrial aspects as well as external influences based upon the empirical findings. By using three-way scenarios, various outcomes and effects of internal as well as external factors within the nations can be discussed. In the scenarios, the most-likely Scenario, is considered to be most probable outcome and development in the two different markets in the next coming 5 years. The forthcoming supplier selection analysis will further draw upon the information presented in the most-likely scenario.¹⁵

2.5 Validity and Reliability

The concepts of validity and reliability are not directly related to the context of the case study and scenario analysis in a research. Rather, it is directly related to the information collected and the instruments used in the research and it is therefore important to investigate and critically consider these aspects to be able to establish the level of validity and reliability in the study. Instead of using the terms of validity and reliability, the following three aspects will be investigated, as they feel more applicable to our research.¹⁶

¹⁵ Georghantzas, Nicholas V. & Acar, William (1995)

¹⁶ Merriam, Sharam B. (1988)

Inner validity – Truthfulness

Reliability - Consistence

External validity – Applicability

2.5.1 Internal Validity – Truthfulness.

Inner validity focuses on the truthfulness of the research and questions if the researchers have studied the reality that they set out to study. It is important to realise that any information gathered will have a personal interpretation by the researcher, hence influenced by their reality. The reality has to be interpreted by the researchers' views of the reality and not the reality itself. According to Merriam (1988) there are several methods for securing the internal validity in the research process.

In this study the method of triangulation has been applied with the aim to create as wide and truthful view of the problem area as possible. As the research problem discussed in this thesis takes a broad focus it is important to have an encompassing approach to the question, before narrowing down to the key questions. To ensure broad and organised research on the markets data was collected from a wide spread study-group. The interview process also included a wide range of persons, organisations and companies to guarantee a thorough understanding of the problem. The aim was to have an even division of interviews between governmental and non-governmental organisation as well as a spread between academics, business professionals and officials to enhance our understanding. As two factory visits were conducted, one in Latvia and one in China, the authors gained an understanding of the purchasing process as price and product negotiations were conducted. This in conjunction with our theoretical basis led us to an enhanced understanding of important attributes within international sourcing. During the field studies the research process has been conducted in similar manners in both Latvia and China and observations has been compared to each other. To further increase the validity as well as accuracy of the end result, interviews have been conducted throughout the whole research process. As the authors gained enhanced knowledge of the subject matter more thought provoking and detailed oriented question have been able to be discussed.

Repeated observations and interpretations of similar questions have been conducted in order to gain a general understanding and reduce the likelihood of biased conclusions. Similar questions have been used in the interviews. The

questions put forth to the respondents have been adapted to fit the expertise of the interviewee. Interpretative questions have been used where the respondent was asked to interpret and describe a situation. Also hypothetical questioning has been used to determine how theoretical situations might evolve.¹⁷

To reduce the risk of biased and misleading conclusions the results of the research have been discussed with other researchers in the same or similar fields. This enhances the truthfulness of the data interpretation and the following findings that enables the authors to discuss the results and to put the research in a bigger context, i.e. answer to the overall problem formulation.

2.5.2 Critical Review of Internal Validity

The weakness of triangulation in this research is that there have not been equal opportunities to conduct interviews on the Latvian and the Chinese market. The support received in Latvia was tremendous and Latvian government officials and organisations made the research and interview process easy. In China however, the research and interview process was far more tedious. Consequentially, a majority of the interviews conducted in China has been with people with relation to the Swedish market in their work, which can lead to an altered view of the reality. In addition some of the respondents in the interview process may have had personal interest in our meeting with an aim to establish contact with ICA for various business purposes. This can create a situation where the respondents gave answers that suit their business ideas.

Merriam (1988) state that control of participants' responses increases validity and most importantly is that the interviewees have the possibility to examine the result of the investigation to establish if the conclusions are in accordance with what they have stated. This has only been possible with interviews conducted at ICA, where the information has been reviewed by representatives from ICA Non-Food to secure the accuracy.

2.5.3 Reliability

The issue of reliability concerns the possibility of establishing the same or similar results if the investigation would be repeated. The reliability is a delicate matter due to the characteristics of societal research and the fact that people and the environment are dynamic in their nature. The reliability and the

¹⁷ Merriam, Sharam B. (1988)

internal validity are strongly connected to each other and according to Cuba & Lincoln, researchers should be more concerned about the internal validity than the reliability because strong internal validity will lead to good reliability.¹⁸

In order to establish the reliability of the research, assumptions and reasoning behind the interest of the research area are presented in the introductory chapter. In addition the triangular method presented in previous section enhances the reliability of the research. Within the educational framework, opportunities have also been given for other researchers and students to give critical reviews of the investigation, which ensures unbiased assumptions of the reality.

As two authors have conducted the investigation, ideas and information have been discussed between the two in order to gain a clear understanding of the problem. Both authors have participated in all interviews and the authors have individually processed the outcome of the interviews, and subsequently discuss findings in order to establish an accurate understanding of the interview.

2.5.4 External Validity

The external validity put forward the question whether the result of the research is applicable to similar situations. The possibility for accurate generalisations in regards to qualitative studies has been intensively debated. The main question is if it is possible to draw generalised assumption from a single case study, and in that case, how broad assumptions can be made.

According to Yin (1994) it is difficult to make generalisations based on a single study, if compared to a correctly selected sample study. This derives from the fact that the survey research relies on statistical generalisations, and case studies rely on analytical generalisation, which is harder to motivate.¹⁹ As stated in the delimitation chapter, the motives behind our selection of case study were explained and it is further supported in the methodological chapter. However, as stated by Yin (1994) no set of scenarios, no matter how large, is likely to deal satisfactory with the complaint of generalisations. Instead, a researcher should try to generalise findings to "theory", analogous to the way a researcher tries to form theories from experimental results. In this way the theory connected to the case could serve the purpose as a vehicle for

¹⁸ Merriam, Sharam B. (1988)

¹⁹ Yin Robert K. (1994)

examination of other cases. This is well connected to this study, where the research process has led to the possibility and the motivation of creating a model applicable for understanding and analysing the sourcing process, further presented in chapter 3.4. In this way both the case study conducted in combination with the theoretical model of sourcing provide incitement for generalisations and make it possible to further apply the model in future analysis of companies sourcing activities. However, the issue of replication logic is important and the theory has to be tested through replication of the findings to establish its prospect for generalisations.²⁰

Merriam (1988) states that researchers can take two different standpoints regarding generalisations. The researcher can either state that generalisations can be made or not to be made. In this research process, the first mention approach is attempted, as a case study is conducted and general conclusions will be drawn upon the end results. Though, it is stated by Stake (1978) that when the aim with the research is to explain, test a hypothesis or law, the research it is often disadvantaged by using a case study as research method. On the other hand, when the purpose of the research is to gain an understanding, widen the experiences and an increase security concerning something that is already known the case study is a preferable method.

In this study the selection of case company, case markets and case product group have been decided upon to enable generalisation. These generalisations will be applicable to the retail industries in general as well as ICA Non-Food's overall product assortments. Furthermore, the generalisation for ICA will also aim to show general trends in the purchasing activities. ICA is one of the largest retailing companies in Sweden and it is believed that other retailing companies have identified similar concerns and questions when it pertains to sourcing activities. It can also be applicable to other international retailing companies outside Sweden.

²⁰ Yin Robert K. (1994)

3 THEORY

This chapter will provide a theoretical background as well as a framework to the research problem. Important theoretical aspects and models will be presented and put into the context of international sourcing. Due to the actuality of the research problem an introduction of international sourcing and its importance in the firm's overall business operations will be discussed. It will subsequently be followed by a discussion of supplier relationships and its magnitude in regards to sourcing and selection of suppliers. This chapter will also present a supplier selection model that will be further applied in the analytical chapter.

3.1 Sourcing; an Integral Part of the Value Chain

Any given company can be divided into various segments or departments. Many researchers and theorists have developed different models in order to analyse firm's strengths and weaknesses in order to improve the overall competitiveness and identify core competencies. When Porter (1985) wrote his book "Competitive Advantage" he introduced his version of the Value Chain model, which identifies the various activities performed by companies. The idea of the value chain is based on the sequential process view of organisations, i.e. inputs, transformation, output, marketing and support services. Taken to the next level, it identifies the consumption of resources; money, labour, materials, equipment, buildings, land, administration and management. Using the model as a basis, one can see the operational flow, cost drivers as well as realise improvements for enhanced profitability. Each identified activity in Porter's value chain is vital in order to develop competitive advantages and it is of importance to realise the interconnectiveness between the separate activities. Since its inception, the value chain has received much attention and has provided a basis for many researchers in their work.²¹

In order to realise sustained growth and manage business strategies in today's rapidly changing technologies and emerging markets, ongoing value-chain adjustments are a necessity in all types of businesses and industries. A company's core capability is its ability to design and redesign its value chain in order to achieve maximum efficiency and profitability. As trends also affect the

²¹ Cambridge University – Department for Manufacturing Homepage

scope of interest in the value chain, three areas have recently received increased attention; sourcing, investments and alliances.²² For retailers today, integration of purchasing distribution, marketing and merchandising is important. The value chain of retailing is more consumer-oriented than in other industries and must be a component of the retail strategy. More directly, the value chain in retailing is a function of service and cost drivers.²³

According to a recent conducted study by Ulf Johansson regarding retailing strategies, it was found that the sourcing activities of an organisation are receiving increased attention as well as becoming further incorporated in the overall strategy of the company. Thereby one cannot separate the buying function from other activities such as product-development, merchandising, quality control, marketing, sales, finance etc.²⁴ There is a widespread awareness of the necessity to control the retailing assortment in order to create a strong retail profile in an international arena. Successful sourcing can contribute as a strategic tool and is undergoing transformation to becoming a pull strategy from a previous focus as a push strategy.²⁵ As researchers have understood this, a value chain modified to be suitable for the retail industry has been developed. Furthermore, as the retailing industry is continuously undergoing changes in its operational structure this is also emphasised. Much pressure is placed on managers to be innovative and find new optimal solutions for present activities. Past innovations within retailing include discount concept, scanner checkout, category management, private label concept and online shopping.²⁶

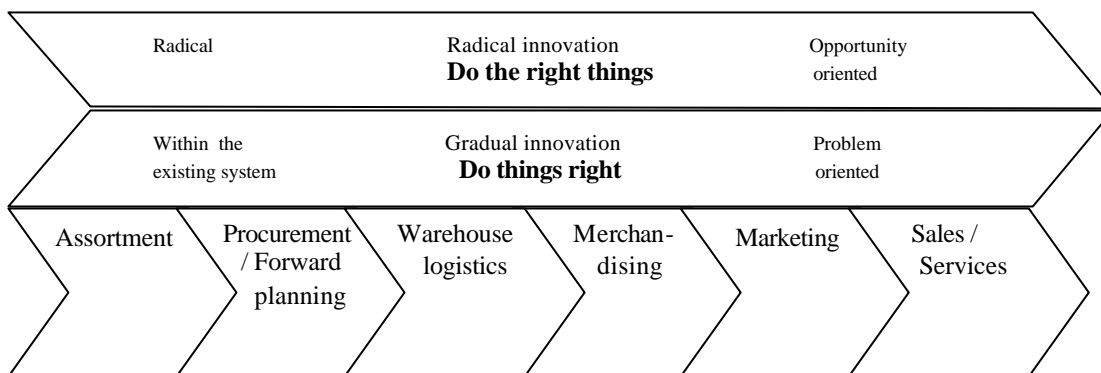


Figure 4; Retail Value-Chain

Source; Liebmann, Hans -Peter et al. (March 2003)

²² Fine, Charles et al. (2002)

²³ Walters, D and Hanrahan J. (2000)

²⁴ Johansson, Ulf (2002)

²⁵ *ibid.*

²⁶ Liebmann, Hans-Peter et al. (2003)

As seen in the model above, the various operating activities are identified as well as the two sources of innovation. As this study will further discuss sourcing activities in emerging markets the emphasis will be put on the Procurement/Forward Planning and the approach will be under the gradual innovation as it is within the existing system and is problem oriented

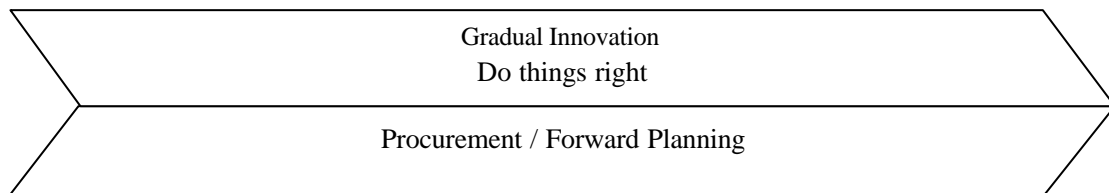


Figure 5, Modified Highlights of Retail Value-chain

Source; Liebmann, Hans -Peter et al. (March 2003)

Procurement/forward planning is from now on referred to as sourcing activities and its related activities in order to create a successful sourcing strategy. Today sourcing has gone through a stage of revival. As a response to the dynamic and complex global business environment companies are developing supply bases in multiple countries in order to stay on the edge of competitiveness.

3.2 Sourcing Evolution and Internationalisation

International sourcing first emerged as a reactive approach to intensified competition and a desire for reduced costs. It must at present be undertaken in a proactive manner in order for firms to stay competitive and realise the full benefits of their operations. Managers must formulate strategies including purchasing rules, evaluation criteria, principles and ethical standards in order to achieve a successful sourcing mix. Though, these strategies cannot be viewed in its isolation, rather, they ought to be a discussion in conjunction with issues of international logistics and inventory management in order to find an optimal solution for a company operating in the global arena.²⁷ By implementing effective global sourcing strategies, desired outcomes include cost reduction, quality and delivery improvement, cycle-time reduction and improved responsiveness of customers, hence global sourcing is today considered a competitive weapon. Organisations today are seriously focused on getting the best goods at the best price and sourcing activities are today becoming integrated in overall business strategies. However, due to two major factors there is still much to learn in companies' sourcing activities. Firstly, due to intensified competition, it has recently been recognised as one of the important

²⁷ Babbar S and Prasad S (1998)

cost and satisfaction drivers within a firm's value chain. Secondly, recent environmental factors such as the abandonment of several trade barriers and the creation and enlargement of regional trade blocks has opened up new opportunities for firms to enhance their competitiveness both in the domestic and international arena by engaging in international purchasing of goods and materials.²⁸

As strategic sourcing is both part of corporate efficiency as well as differentiation, academics divides sourcing capabilities into two groupings; Universal capabilities are capabilities carried out in similar manners by all organisations with aim to increase the overall efficiency and cost reduction. On the contrary, Differential capabilities will in conjunction with the firm's business strategy enhance the competitive advantage of firms. Similar to a business plan, a well-done sourcing strategy reflects a deep understanding of industry economics and presents a compelling case for investment. The following model furthermore describes this:²⁹

<p>Universal Capabilities</p> <ul style="list-style-type: none"> • Modeling total cost • Creating sourcing strategies • Building and sustaining relationships 	<p>Differential Capabilities</p> <ul style="list-style-type: none"> • Integrating the supply web • Leveraging supplier innovation • Evolving a global supply base
---	---

Figure 6, Firms' Sourcing Capabilities

Source; Laseter, T (1998)

As of today, global sourcing is primarily motivated by two different imperatives:

1. Suppliers outside home market may offer superior technology or lower labour costs.
2. Global expansion into a new market often forces a company to establish a local supply basis there.

Though, as a recent survey indicated, the key driver for internationalisation of global sourcing is the desire to capture low labour cost, thereafter comes technology. Importers using global sourcing tend to look to developing countries with competitive labour costs to perform simple processing technologies.³⁰

²⁸ Nolan, Alexis (1999)

²⁹ Laseter, T. (1998)

³⁰ *ibid.*

The transition from domestic purchasing to global sourcing is an evolution that moves forward by experience (learn-by-doing) as well as changing external environment (removal of trade barriers, liberalisation of economies and intensified competition). Many researchers within this area of expertise make a distinction between international purchasing and global sourcing whereas the latter is the most advanced.³¹ International purchasing is described according to Trent as being a commercial transaction between a buyer and supplier learned in different countries. Global sourcing on the other hand differs in scope and complexity. It is assumed to involve proactive co-ordination between practices, processes, designs, technologies and suppliers across worldwide procurement, design and operating locations.³² First experience of foreign produced goods is most often purchased within the domestic market from a domestic supplier. As a second step, the buyer realises the savings, both in terms of price and quality that can be realised by sourcing internationally. An intermediary (agent, broker or trading companies) who guarantees quality, price and delivery most often aids the first international experience. As a last step in the internationalisation process the purchasers cut the “middle man” and deal directly with the foreign supplier. This will in most cases provide the best cost-efficient solution for companies while imposing larger risks and requirements of the firms developing a good supplier selection strategy. Many researchers within this area foresee the development of IPOs (International Purchase Organisations) as a requirement for long-term successful global sourcing strategies.³³

As global transactions steadily increase, international purchasing, inventory management and logistics are today treated with due diligence. They are expected to adapt a strategy for purchasing that identifies the right approach for various products rather than a “one solution fits all” policy. In this strategic approach, firms must take into consideration the interaction between the competitive advantage of firms and the comparative advantage of countries. In sourcing strategies, it is the comparative advantage of countries, i.e. location-specific advantage that affects firm’s decision of where to source. It is based on Porter’s basic assumption that factor costs in one country are lower than in another, hence competitive advantage. Although, in the international setting, many factors may offset or hinder the transfer of competitive advantage; Institutional and cultural factors may cause external barriers for the transfer of

³¹ Trent, Robert J. (2002)

³² *ibid.*

³³ Giunipero, Larry C. (1997)

competitive advantage and transportation costs and macro economic factors vary considerably between nations and consequently increase risks and uncertainty.³⁴

More and more firms are today looking towards emerging countries for sourcing options attracted by the competitive prices offered. Often these markets also do provide the best competitive solutions, but it is important to highlight the challenges risks involved when trading with emerging markets and to understand the variables influencing the economic and social climate. Different researchers highlight different aspects of importance, Monczka and Trent (1991) identify the primary factors for evaluating emerging markets as potential prospects for international sourcing to GNP and per capita income, inflation rates, currency and exchange rate movements, import duties and political stability. Secondary factors involved tariff barriers, membership or potential membership in a multinational economic or political group, transportation costs, communication, technology and culture.³⁵ Hokey Min further extends Monczka and Trent's criteria to also include more non-financial variables and in figure 7, Min's supplier selection model is presented, which later on in this chapter will be modified in order to better suit the research area.

³⁴ Frear, Carl R, Alguire, Mary S (1995)

³⁵ Babbar S and Prasad S (1998)

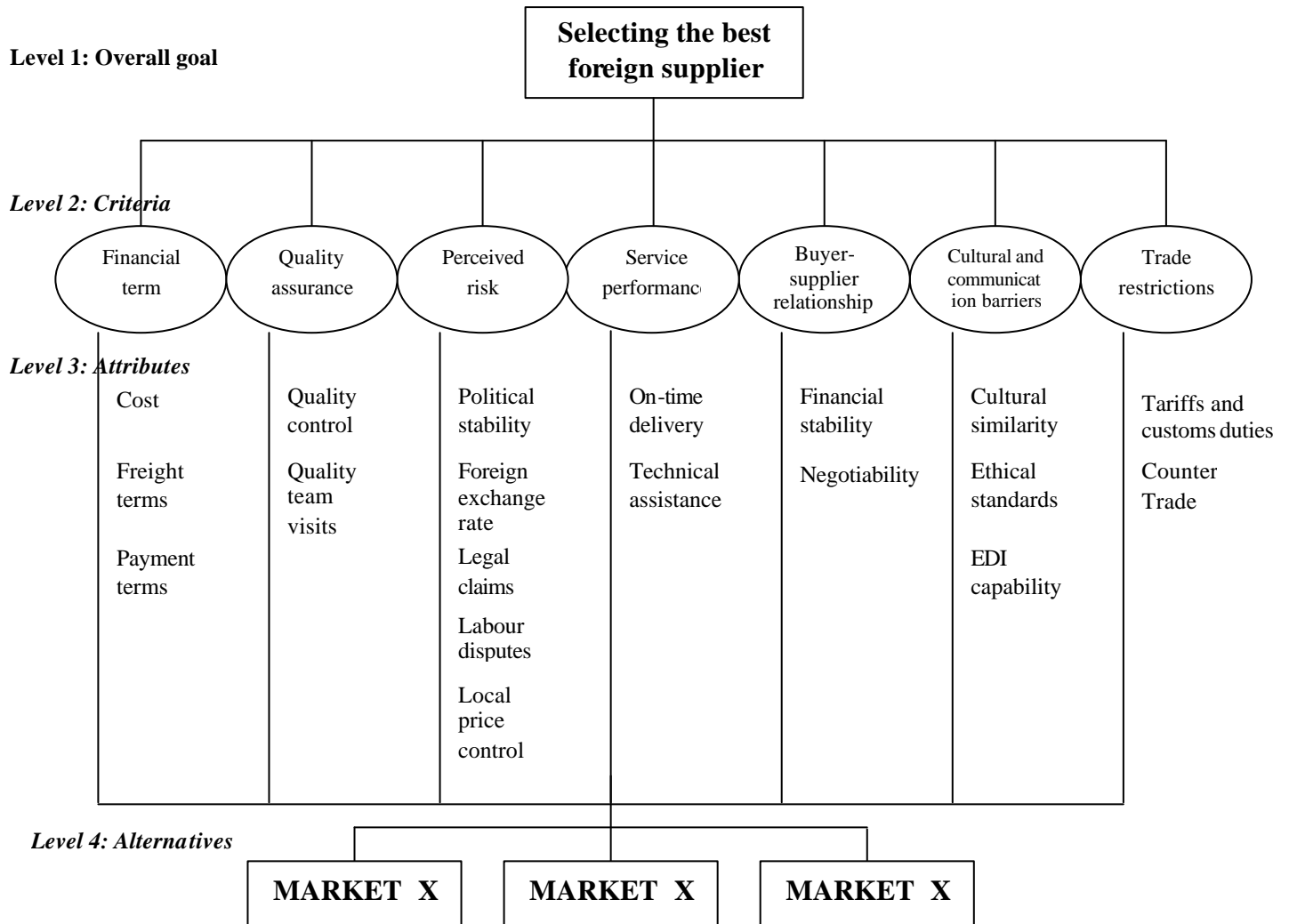


Figure 7, International Supplier Selection

Source; Min, Hokey (1994)

The model was presented as early as 1994 and derived from an aim to explain supplier selection in the turbulent world present at that time. Hokey Min (1994) refers to three aspects and historical events taking place; the official formation of the European Community (EC) and the Single European Act, the end of Communism in the Eastern Bloc Countries and the pending approval of the North America Free Trade Agreement. He further explains how these changes has “contributed to the globalisation of the world economy and this increases the number of firms that once concentrated on domestic sourcing but are now seeking their supply bases around the world”³⁶. It is interesting to see how well-connected and applicable the circumstances in 1994 are to similar changes occurring in the world today. The enlargement of the European Union, the

³⁶ Min, Hokey (1994)

opening up a China as a world market and a development and enhancement of trade unions is in evidence in the world today, and therefore the model of International Supplier Selection is clearly applicable to current situation.

The issue of combining both quantitative and qualitative aspects of the sourcing process is presented by Min as elementary when handling the opportunities and risk connected to international purchasing and therefore he introduces the Multiple Attribute Utility Theory. It is stated to enable the decision-maker to structure a complex problem in the form of a simple hierarchy and to subjectively value a large number of quantities and qualitative factors in the presence of risk and uncertainty. Hokey Min uses a data program to be able to weight the attributes in his model to fit each specific decision-maker in the purchasing decision.³⁷

The calculation and data establishment of the sourcing process and supplier selection is considered a simplification of reality. Furthermore, the model lacks the analysis of the specific product and the aims to establish a long-term and high involvement relationship between the supplier and the buyer. These issues will be further dealt with later in this chapter.

3.2.1 Food Retailing Sourcing

Ulf Johansson (2002) describes the food-retail sourcing concept and views the process in a wider holistic context. He identified features like price, quality, and reliability, as factors of great importance, though when used alone would give a one-sided view of the supplier selection mode. Preferably, the decision ought to be seen as an integral part of the organisational operations, viewing the decision, as one part of a process building up to the overall business structure that would provide increased understanding of retail buying. Generally, it is suggested that the sourcing processes contain activities like problem recognition, products specification, supplier search and choice and finally evaluation. These activities are carried out by a buyer but often supported by several other internal and external resources. By that Ulf Johansson says it could be stated that sourcing is carried out in an organisational context and that several organisational factors influence retail sourcing. The level of integration refers to different types of integration;

³⁷ Min, Hokey (1994)

between retailers, wholesalers and/or producers as well as the inter-functional integration within the organisation.³⁸

Another aspect of the buying organisation is the degree of horizontal integration. A wholly owned chain of retailers will exhibit different communications and buying patterns than for example a co-operative chain of multiple retailers. This is because the variation of how they organise the purchasing activities. Generally a more elaborate internal organisation is needed in organisations with lower degree of vertical integration.³⁹

As successful sourcing is difficult to achieve, Laseter (1998) has in his book, *Balances sourcing*, identified the key steps to effective sourcing strategies:

1. View supply-base rationalisation as a result, not the objective.
2. Use multifunctional teams.
3. Coordinate across regions and business units where necessary.
4. Conduct rigorous global research.
5. Examine total cost of ownership.
6. Segment the spend for focus and to break compromises.
7. Quantify the benefits.

Few purchasing decisions should be based solely on the product's purchase price rather, a cost model should include factors such as shipping expenses, quality cost and inventory cost. In addition non-price variables such as confidence, cultural understanding etc do also play an important role in some sourcing activities.⁴⁰

3.3 Supplier Relationships

The creation of long-term relationships can be both beneficial as well as a source for problems. According to a study made by Ulf Johansson on retailers in UK, Italy and Sweden (2002) the sourcing process simplifies (fewer steps and activities) as the relationship with a supplier goes on. However, a long-term orientation of a relationship also complicates the buying process since new dimensions becomes evident in the relationship by involving social and co-operative dimension that increases the complexity as well as the switching cost. Depending on which industry the company is operating, the importance of

³⁸ Johansson Ulf (2002)

³⁹ Johansson Ulf (2002)

⁴⁰ Laseter, T. (1998)

purchasing and the complexity of the market differ. This will effect the relationship that will be established with the supplier.

There are different types of relationships and networks existing today, most commonly divided into vertical and horizontal relationships. The horizontal relationship refers to the creation of co-operation between companies, often in the same industry. One example of this could be the AMS Purchasing group, further explained in chapter 4.1.2, where a number of retailers conduct purchasing together to reach economies of scale. The vertical relationship, which will be in focus in this research, refers to the relationship between a buyer and a supplier.

The benefits of close relationships between the buyer and supplier have been emphasised by several researchers, and many claim that it is a post-modern syndrome. Close relationships enable the parties to learn about each other and to adapt to each others needs in order realise maximum benefits from others skills and resources. It is unlikely that companies will be able to benefit from each other or make return on their investment in one single transaction, therefore the two companies are likely to invest in a long term relationship. However, it has to be stated that learning and adaptation often takes long time and are expensive. In some cases companies benefit more by “shopping around” for their needs as they arise and deal with their suppliers in single discrete transactions.⁴¹ In this study the approach is that companies must constantly re-asses their relationships and manage each one in accordance to its individual benefits and in-line within their overall strategy.

3.3.1 Low Involvement Relationships

When a buyer and supplier establish close activity link or resource ties they become dependent on each other. Sometimes the buyer strives to avoid this dependence on individual suppliers to give themselves the freedom to change. According to Ford (2002) these so-called arms-length relationships have four major advantages.

1. They are inexpensive to operate.
2. A number of suppliers can help overcome short-term problems of fulfilment, such as delivery failures, problems with product or service quality or fluctuations of demand.

⁴¹ Ford Davit et al. (2002)

3. Much investment in a single relationship might mean that the customer is “locked in” to that supplier in the long-term.
4. High involvement with a single supplier makes it difficult to encourage different suppliers to compete by improving their offerings or reducing their prices.

The low involvement approach to supplier relationship considers suppliers as more or less efficient producers of identical inputs. The price orientation of purchasing ignores the affects of fixed cost in a purchase. It is also rather adversarial, so that a price reduction is a gain for the buyer and a loss for the supplier and vice versa.⁴²

3.3.2 High Involvement Relationships

This view is based on another idea of purchasing efficiency and a different approach to the role of suppliers and the nature of relationships. Companies increasingly have to rely on the resources of outside suppliers, this means that many of the purchasers’ activities have to be co-ordinated with those of its suppliers. The purchasers engaged in high involvement approach uses a long-term strategy and will not strive to minimise the price in a spot transaction. Rather it will aim to improve its operation in the long-term perspective by using the resources of its suppliers more efficiently. This approach also involves the buyer using suppliers in its product development to enhance the offering to its own customers.⁴³

The level of involvement concerning supplier relationship can be stated to have different level of importance in different industries and different product groups. However it should be stated that there is an increased interest in applying long-term relationship with suppliers.

3.4 Model for Retail Sourcing

The presentation of the Supplier Selection Model (Figure 9) gave a checklist of what factors that has to be taken into consideration in the process of selecting a supplier. As stated before, the model takes a very simplistic view of the process by only presenting the important attributes without any specific order or sequence. In addition, it fails to include aspects of product analysis and supplier relationship. By connecting the Supplier Selection Model with the discussion of

⁴² Ford Davit et al. (2002)

Supplier Relation, and product analysis, a modified model developed and is presented below.

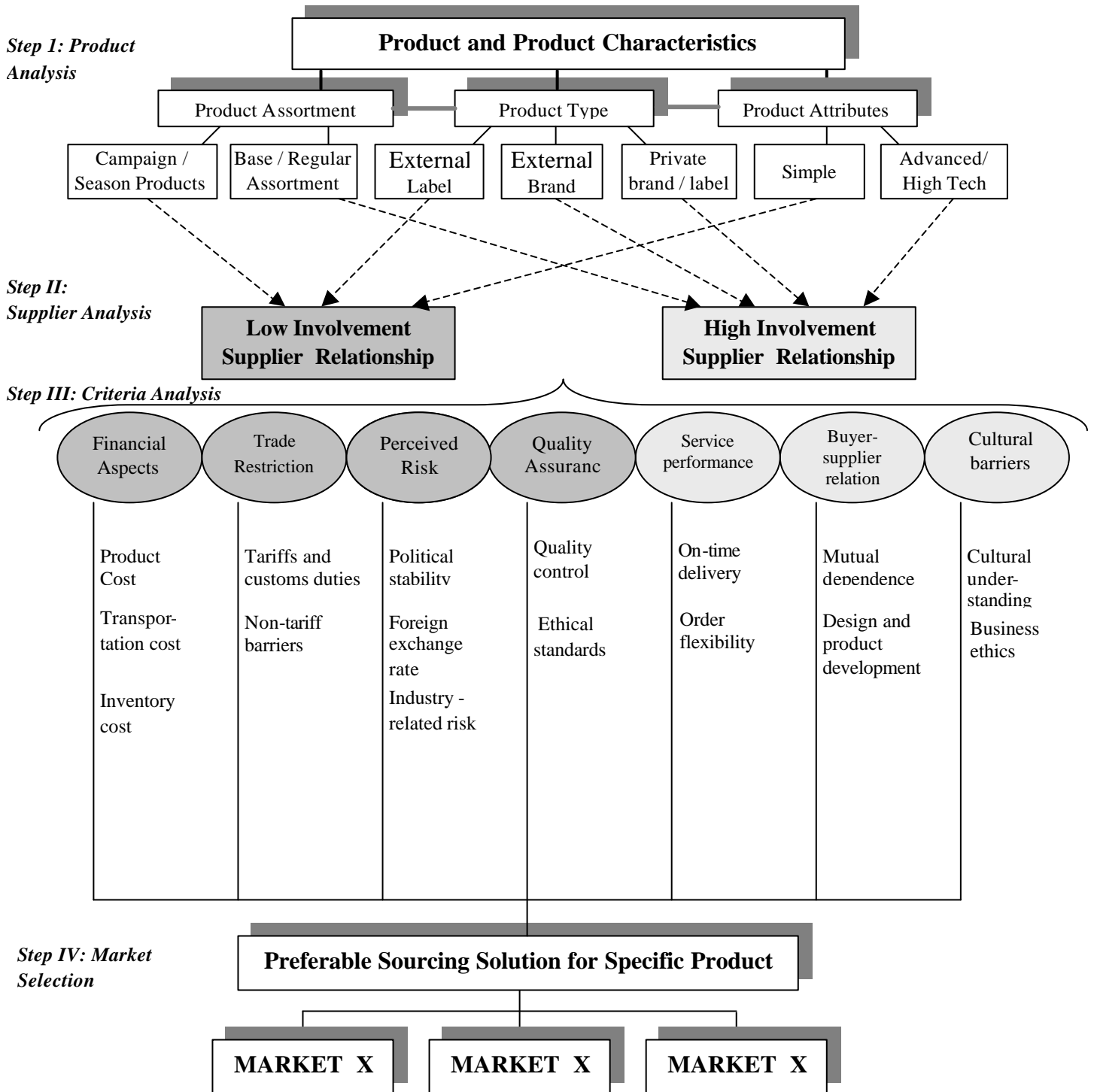


Figure 8; Modified Model of Supplier Selection Process

⁴³ Ford Davit et al. (2002)

The model takes an overall view of the sourcing process and is also suggesting different broad steps in the sourcing decision. The model takes both an internal and external approach. Firstly, the model analyses the process from an internal perspective with an emphasis on the product and the supplier relationship. Secondly, the analysis considers external conditions on the investigated markets, by conducting a criteria analysis. Because of the extensive difference between the characteristics of products within the retailing industry it is not possible to weight the importance of the different factors and attributes. For example, the existence of tariffs and quotas is not evident in most product categories and therefore not considered important by most purchasers but in a products group such as textiles it is one of the most important aspects. This model will be used to analyse the sourcing activities in the case study conducted in this thesis, and serve the purpose as a framework of sequential analysis of general sourcing within the retailing industry.

The first step refers to an analysis of the product's characteristics. The main concerns are the Product Assortment, Product Type and Product Attributes. The first aspect, Product Assortment, focuses on the function of the product. If the product is a part of a basic assortment it is most likely that regularly orders will be made, instead of fashion or season products where different orders are made each time. The second, product type, refers to if the product is a private label, external label or external brand. Depending on product type, different levels of involvement with suppliers are required. The importance of finding a reliable supplier increases if the company brand name itself is connected to the product. The third aspect is Product Attribute, which refers to the technological complexity of the product. Electronic equipment like coffee machines require a closer relation to the supplier, in comparison with for example barbeque firewood, because the risk connected to electronic products are far more extensive. This leads up to the second step of the sourcing decision is to consider the relationship that is preferable in the purchasing process.

As stated before, there are two types of relationships, first the establishment of a high-involvement relationship seen in a long-term perspective, and secondly, if the purchase is made as a transaction with low-involvement relationship with the supplier. It is important to analyse how the company will utilise the supplier in a future perspective and investigate if benefits can derive from developing a relationship in a long-term perspective or not. Of course, the level of involvement with the supplier will vary between high and low in different

situations but the model gives an indication of the importance of relationship. The model further shows that if a high-involvement relationship is preferred it is important to consider all aspects within the attribute analysis. If the preferable solution of a purchase is low-involvement, i.e. transactional mode, the attributes marked dark grey is of most importance. Though, they do not exclude the attributes with light grey colouring, but these are not considered important to the same extent as when a high-involvement relationship is preferred.

Following the picture, the third step is a thorough market screening of the attributes connected to the product and the purchasing process. The purchaser has decided on a limited number of potential markets and these will be analysed in market-related attributes. The importance of the respective attributes in the model can differ widely depending on product type. By this screening of attributes it should be possible to reach a decision on a most suitable market.

3.5 Theory Reflection

This chapter has provided a theoretical framework to the problem area investigated in this study. Initially, a theoretical background to the increased attention and importance of international purchasing was presented, to give the reader an understanding of previous research in related areas. This was followed by a modification of the presented supplier selection model to better fit the research area in this study and provide a tool for analysing the purchasing process in a supplier selection perspective. The purpose with the improvement of the model developed in this chapter is to theoretically assist purchasers in the supplier selection process.

An aspect of interest that became apparent during the theoretical research was the lack of theoretical discussion within the area of retail sourcing. Numerous articles and literature discuss the concern of other parts of the value chain but takes a more customer oriented focus. Furthermore, much of the sourcing theories published related to the industrial sector, which apparently is far more advanced within international sourcing. The lack of comprehensive sourcing strategies within retailing was surprising as strategic sourcing has almost been a fad term for quite some time, which most often stimulate researchers to find solutions and rationales for the performed activities, i.e. retail sourcing. As

most international sourcing literature is focused on industrial sourcing, its foundation derives from network and relation building within the supplier system. However, there are clear signs indicating that there is and will be increased attention towards retail sourcing as numerous recent articles and books are dealing with the concern of how to conduct strategic sourcing.

An astounding finding within the theoretical analysis was the apposite fit of the applied model developed and presented by Min in 1994. After profound screening of theoretical model and tools to be applied within the research, the model by Min was found most appropriate in the current global situation of market dynamics. However, the model has been modified to be able to highlight the concerns of market screening in a current and encompassing perspective.

In addition, it was difficult to find theories managing the process of sourcing in a holistic perspective, as most theories pointed towards one or a few aspects of the process. This is not considered a limitation in those theories but it fails to provide an overall view of the process, which is important when conducting a case study.

As indicated above, there was a need of creating a fresh and innovative model to be able to base our research on and it is the authors' belief that the model succeeds in taking a broad and comprehensible view of the sourcing process. The model will later be applied to two products within the Home Textiles department of ICA Non-Food, which will both provide indications of the applicability of the model and state the sourcing potential in the two investigated markets. Before the analysis is conducted a thorough presentation of the characteristics of the retailing industry including the case company, followed by a presentation of the two investigated markets.

4 SWEDISH RETAILING AND EMERGING MARKETS

The empirical chapter will give a pragmatic picture of the current issues of retailing and the present status of the two researched markets; China and Latvia in order to prepare for future scenarios and establish sourcing potentials. The chapter is divided in two main parts. The sections are independent but will later be connected in the analytical chapters of the thesis. The first part will take a retail perspective and describe the changes occurring in the Swedish retailing industry and subsequently present ICA, ICA Non-Food and the Product Group of Home Textiles within ICA Non-Food. It will lastly present the global textile industry and give an explanation of the current situation and future concerns. The second part of the chapter will take a market perspective and describes the two different markets investigated in this research, starting with China and then Latvia regarding highlights of the political and economical situation as well as the important industries with an extra emphasis on the textile industry. The presentation of the markets will be viewed in the context of sourcing and therefore focus on the aspects of importance to access if purchasing activities will take place today and in the future.

4.1 New Imperatives in the Retailing Industry

The retailing industry is currently undergoing radical changes, both internal and external. This is influencing the operating market, product assortment and supplier selection. Internal changes such as development of private labels are more or less a response from external changes, such as an increase in global competition and a trend of mergers and acquisitions restructuring the industry. In addition to this, macroeconomic changes like the EU enlargement and WTO modification of the regulatory framework are changing the rules of the global retailing industry. Consequently, different imperatives for competition are prevailing and as strategy is a key word, flexibility within is a must for success and survival. It opens up for opportunities, though it is important for firms to actively respond to the new products, technology and customer demands in order to succeed. This chapter will present important aspects concerning retailing with a starting point in the Swedish food retailing industry and the case company ICA, then narrows down to the textile industry and the dynamics of the textile industry in a global perspective. This chapter provides a

framework to be able to further investigate the potentials of retailing in the two investigated markets in the two following chapters.⁴⁴

4.1.1 Swedish Food-retailing Industry

Total retail sales in Sweden grew by 23 percent in current terms between 1996 and 2001, to reach over 437 billion SEK in 2001. Constant value growth was 18 percent over the same period. However, retail sales are divided into the food and non-food sector, the non-food sales refer to retailing companies on the Swedish market like IKEA and H&M. Total retail sales is forecasted to reach 511 billion SEK by 2006, with non-food accounting for an increasing share of sales. Non-food sales are forecasted to grow much faster than food sales, at 21 percent versus 13 percent in constant terms over the forecast period, hence the increased focus on non-food items by grocers.⁴⁵

During recent years food-retailing chains have increased their market share, in food as well as in non-food. In food retailing, three chain companies had a market share of around 70 percent of the sector sales in 2001, these are ICA, COOP and Axfood. Many critics claim that this has reduced the competition within the market, and consequently worsened the situation for the consumers by higher prices and smaller selection of products. The entrance of the German food-retailing giant Lidl in October 2003 into the Swedish market will further pressure grocers as well as speciality stores that are competing in regards to the non-food products.⁴⁶ Food retailers are taking a growing share of non-food sales and benefit from the large increase in sales of non-food products. All major food retailers have their own private labels, and all are striving to increase the proportion of own products and labels, as the profit margins are higher on these products. In 2001, 11 percent of retail sales in food outlets came from private labels, though it is expected to increase in the coming years. One of the forerunners in Sweden is ICA, which in 2001 released a wide range of new private label products under the company brand ICA. Private labels in Sweden are on average 27 percent cheaper than branded products within the food-retailers.⁴⁷

When comparing the division of non-food and food products within the food retailing chains one has to consider the different store formats, who are based

⁴⁴ Gilliam, Margareta (2001)

⁴⁵ Euromonitor 2003 -

⁴⁶ Engeseth, Stefan (2002)

on the store size and turnover. Two major store segments prevail; Supermarket and Hypermarket and the average sales of non-foods within these two segments in the Swedish retailing industry is levelled at around 28 percent.⁴⁸

4.1.2 ICA

ICA is the largest grocery retailer in the Nordic countries with 40 000 employees and 3000 stores within Scandinavia and the Baltic States. The vision of ICA AB is to make each day a little easier for their consumers, and the overall goal is to become the leading grocery retailer in Northern Europe.

A significant event in Swedish retailing in recent times was the Dutch retailing chain Royal Ahold's acquisition of 50 percent of the shares in Sweden's ICA AB late 1999. At this time ICA AB had established its position as the market-leading grocer in Sweden. Due to competition rules adhering they tried to find an international partner, as there were limited growth opportunities in Sweden. Together with Royal Ahold, and as a part of ICA AB's strategy to strengthen the position within the Scandinavian market, ICA AB acquired 50.1 percent of Danish supermarket chain ISO Supermarked A/S in 2001 and has recently increased this to a 100 percent ownership⁴⁹.

Royal Ahold, the main owner of ICA, by its 50 percent ownership, is a global grocery retailer with approximately 420 000 employees and operations in the US, Latin America, Asia and Europe. Although, due to recent accounting issues, Royal Ahold has been forced to liquidate many of its assets and is downsizing its international operations. More sell offs are expected as profits were dramatically lowered (i.e. losses were understated) in the restated earnings presented this year. Beside the Royal Ahold ownership of ICA AB, 30 percent is owned by ICA Förbundet Invest AB and 20 percent by the Norwegian firm Canica AB.. ICA Förbundet Invest AB is primarily owned 75 percent by ICA Förbundet (membership organisation for ICA storeowners) and 25 percent ownership by 3 300 independent stockowners whereof the majority are ICA-store owners or employees. The 20 percent owner, Canica, is a Norwegian private investment company owned by Stein Erik Hagen and his family.

⁴⁷ Euromonitor 2003

⁴⁸ *ibid.*

⁴⁹ *ibid.*

ICA AB is divided into an umbrella organisation with subdivisions in several different market segments, as well as nations, seen in the organisational chart below whereof ICA Sverige AB is the largest segment and also the founding organisation. The dotted lines represent partly owned subsidiaries whereas the solid line shows full ownership, excluding the recent acquisition of the remaining shares of ISO-ISA AS. ICA Sverige AB is the market leading grocery chain in Sweden as well as the largest firm within ICA AB with its 1764 stores. Total turnover in 2002 amounted to 76,1 billion SEK, which is an increase of 6,4 percent from previous year. According to recent statistics one third of Sweden's total grocery shopping is conducted at an ICA store.

The Swedish ICA stores are working as a co-operative chain whereas the ICA store manager owns and runs his/her store independently. ICA Sverige AB is referred to the independent ICA stores throughout Sweden, and ICA AB is the Mother Company supporting the main functions. Hereafter in the report, no separation will be made between ICA AB and ICA Sverige AB, it will be referred to as ICA, separation will only be between ICA and ICA Non-Food in order to facilitate for the reader.

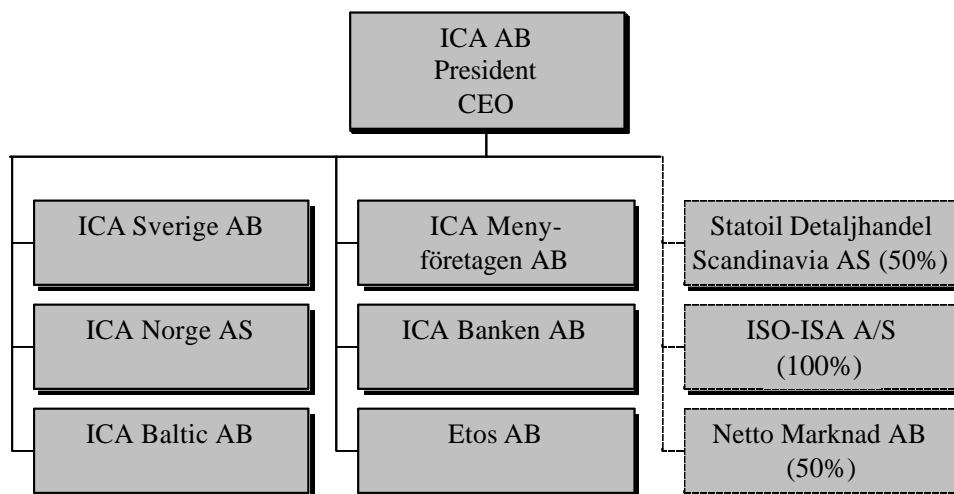


Figure 9, ICA AB Organisational Charts

Source; ICA Internal Material

As mentioned in previous the chapter retailers are often divided into different profiles based on size and turnover. The ICA grocery stores are divided into four different profiles based upon size, turnover, assortment and geographical location:

1. ICA Nära - smaller stores for daily purchases
2. ICA Supermarket - located either in the living or working communities and is built to function as a primary source for daily and weekly purchases of groceries.
3. ICA Kvantum - offers a large selection in their product assortment in order to offer the customers the possibilities to conduct planned and large food and non-food shopping. The store location is easily accessed by car and ought to offer good parking possibilities.
4. MAXI ICA Stormarknad - offers a complete assortment of products used for all aspects of daily life.

The product assortment within ICA is divided into three different levels based to be able to provide each of ICA's profiles the right products. The following picture can explain the division of assortment.

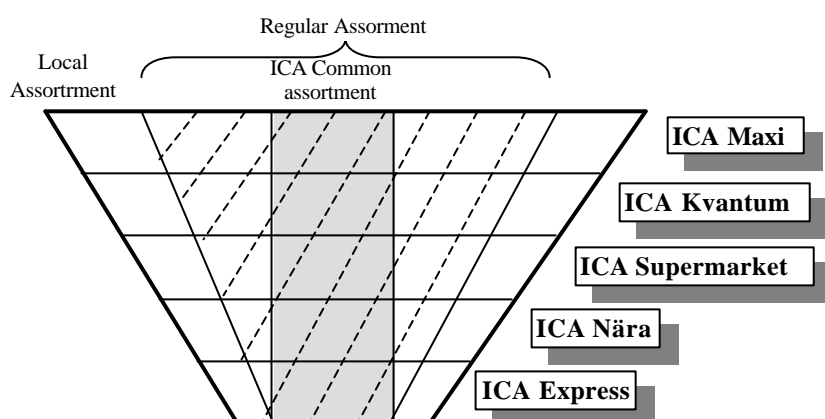


Figure 10, Modified Picture of ICA Product Assortment
 Source; ICA Internal Material, *Leverantörsguide 2003:1*

The smaller local stores focus on the necessities of the daily life. As the size of the ICA stores increases, a wider array of assortments can be found. While all ICA stores maintain a common assortment of goods, the extent of the regular assortment grows with the size of the ICA store. These assortments are common and controlled among all ICA stores and variation is limited to the local assortment branch of each stores.⁵⁰

In order to enhance the selection of supplies as well as reduce the prices for the consumers, ICA has recently focused on developing more private labels. As mentioned before, this is a trend among most retailers and ICA is one of the forerunners in this process within the Swedish food-retailing sector. Although,

⁵⁰ *Leverantörshandbok ICA 2003:1*

it is believed that private labels are a recent innovation, but ICA promoted its own coffee, Luxus, as early as 1922. Not until recently, have these products gained a significant market share within the overall assortment and sales. The general strategy of private labels, food or non-food products, state that they ought to be equivalent to market leading brands but priced below. The main purpose is to increase overall customer satisfaction. Today, ICA has several different labels whereof the most famous is the ICA logo which are mostly used on food. Other labels within non-food include Deco Design and Prima Cookery. In the overall assortment in ICA the private labels constitute about 12 percent, and the aim is to increase this one percentage annually.⁵¹

4.1.2.1 ICA's Sourcing Strategy

Within ICA there are different levels of purchasing strategies and organisations, depending on what products or departments are concerned. One of the most important aspects of the sourcing process is the negotiation with suppliers, to be able to provide the consumer with good products to competitive prices. As ICA is a food-retailer and a great part of the assortment derives from fresh food, many of its suppliers are consequently actors on the Swedish market and they negotiate directly with ICA Handlarnas AB, which is represented by the storeowners. However as ICA also is a part of the Ahold concern, this should be exploited in the negotiations with big suppliers. The ICA negotiations are taking place in four different levels based on the geographical use of the products, described below.

Global / European	Ahold Global Sourcing / Ahold European Sourcing Mostly large-scale coordinated campaigns.
Nordic	ICA AB Refer to the Nordic companies included in ICA. Negotiation concerning ICA's private labels and large suppliers providing numerous of ICA's stores with products.
Swedish	ICA Sverige AB Most negotiation takes place on this level, referring to the common food products present in an ICA Store.
Local	Individual Stores ⁵²

⁵¹ ICA Internal Homepage

⁵² Leverantörshandbok ICA 2003:1

In addition to the above-mentioned intra-organisational co-ordination of purchasing activities, ICA is also member of a vertical alliance formation between different international retailing chains. There is clearly a trend developing of the creation of alliances within the retailing industry where retailers, operating on different markets, cooperate to gain economies of scale. The Associated Marketing Services (AMS) is an assembly of different retailers in Europe including for example ICA, Kesko (Finland) and Albert Heijn (Netherlands). The membership of the alliance is dynamic due to many mergers and acquisitions within the industry and it is not appropriate to be in the same alliance as a competitor.⁵³ The purchase process within the AMS-group is rather complex as it, to a large extent, is based on consensus decisions between the members. It is difficult to find appropriate solutions for all member markets as the taste and demands of customer's differ. However, it is believed that the purchasing within alliances and vertically integrated organisations will increase as it reduces the cost.

The quality control of suppliers is of utmost importance to ICA. Within the food sector the Hazard Analysis Critical Control Point (HACCP) principle must be implemented by the suppliers, which means that the contractor needs to have a system for control in the production process. One example of this could be control that no glass pieces or other hazardous particles can be found in the production process. Within the non-food sector it is stated that all suppliers should follow the ISO 9000 principles. Also the social responsibility of the suppliers is distinguished by ICA and it recommends its suppliers to work towards the SA 8000 standards (Social Accountability), which includes control of child labour, working hours and other working conditions.⁵⁴

Another important aspect of ICA sourcing strategies is the transportation procedures from the supplier to the Swedish market. It has several different policies depending of which market it is operating within. Ex-works is most commonly used on the Swedish market and then ICA is responsible for the transportation directly from the supplier to ICA's storage. Concerning imports, the most common transportation terms are FCA (Free Carrier), FOB (Free On Board) and DDP (Delivery Duty Paid). FCA means that the supplier hands over the goods, after export declaration, to a carrier, decided by the buyer. FOB stand for a procedure where the supplier hands over the goods after shipping.

⁵³ Elg & Johansson (2000)

⁵⁴ Leverantörshandbok ICA 2003:1

Finally, DDP signifies that the supplier hand over the goods after import declaration on the buyers home market.⁵⁵ ICA strives to negotiate FOB terms with its supplier in order to gain control of the goods at shipping points where it does not need to be involved in foreign custom procedures but control the logistics and the cost connected.⁵⁶

4.1.3 ICA Non-Food

ICA Non-Food is a purchasing organ for non-food products operating under ICA since 2002. The history of ICA Non-Food goes far back but the operational form of today took shape in 1992 as ICA Specialvaror was created, further developed to become ICA Non-Food in 2000. The organisation is located in Gothenburg and is responsible for developing and supplying ICA stores with non-food products. The non-food division of ICA Maxi stores are owned by ICA and not by the independent storeowner, and it is operated by Maxi in Växjö. The Maxi unit is responsible for marketing, finance, consumer contact etc. within the MAXI stores. Consequently, ICA Non-Food control the non-food parts of the Maxi stores, which gives ICA Non-Food high level of control of product assortment etc. Maxi and ICA Non-Food are working in a close relation in order to continuously improve the assortment and be adaptive to changes in consumer preferences. The second largest store segment of ICA is Kvantum and together with Maxi they are the two most important store segments for non-food products. The other two segments, ICA Supermarket and ICA Nära, are primarily focus on food assortment, but still important for certain non-food products.

However, one must remember that ICA today is primary a grocery store and even if the store area of non-food products is increasing, approximately 7,5 percent of total sales derives from non-food products amounting to 4 600 million SEK in 2002. However, in the ICA Maxi segment the share of non-food sales amounted to approximately 19 percent.⁵⁷ As ICA is mainly considered a food grocery chain it is interesting to put the turnover of the Non-Food division in a larger context. If comparing the sales of non-food products within ICA 2002 with the sales for Åhléns, which is a Swedish retailer with similar product assortment as ICA Non-Food, the Åhléns sales in 2002 amounted to 4350 million SEK (including their Kicks stores).

⁵⁵ Leverantörshandbok ICA 2003:1

⁵⁶ Bölling, Hans, International Freights and Customs Manager, ICA AB Stockholm

⁵⁷ ICA Non-Food Internal Material

The development of private labels within ICA Non-Food has increased dramatically during the last years, and they have had a long experience with private labels, initiated 25 years ago with the introduction of the pantyhose brand Soaré.⁵⁸ As previously stated the proportions of private labels are increasing within ICA but it is mostly visible among the non-food products. This may partly be explained by the fact that non-food products within ICA Non-food segments do not have the same brand identity attached to it as food products such as Coca-Cola and Heinz ketchup have. Furthermore, the risk involved in own food production is not comparable with most non-food products, excluding electrical items and certain other products.

Sports & Leisure products	3,1%
Home products	28,2%
Clothing	6,3%
Kitchen products	52,5%
Media products	18,6%
Total ICA Non-Food	20,6%

Figure 11, Division of ICA Own Labels

Source; ICA Internal Material

The figure above shows the percentages of sales of private labels within respectively product area of ICA Non-Food. The most outstanding level of private labels is in Kitchen products where 52.5 percent of this year (October 2003) sales of kitchen products derives from private labels. The total sales of private labels within ICA Non-Food amounts to 20,6 percent, which is very high, compared to the overall ICA number of 12 percent.

The organisational structure of ICA Non-Food is mainly divided between four Category Managers (Sport & Leisure; Home & Kitchen; Clothing; Media), which hold the overall responsibility of the different Categories of ICA Non-Food's product assortment. They furthermore rely on the Product Managers to further build product groups and assortments within the four large niches of product offerings. The responsibilities of the Product Managers ranges from developing an assortment to sourcing the final product.

⁵⁸ Pettersson, Stefan, Category Manager Kitchen & Home, ICA Non-Food

The global presence of ICA Non-Food sourcing activities is increasing and the most important sourcing markets are presented in following graph.

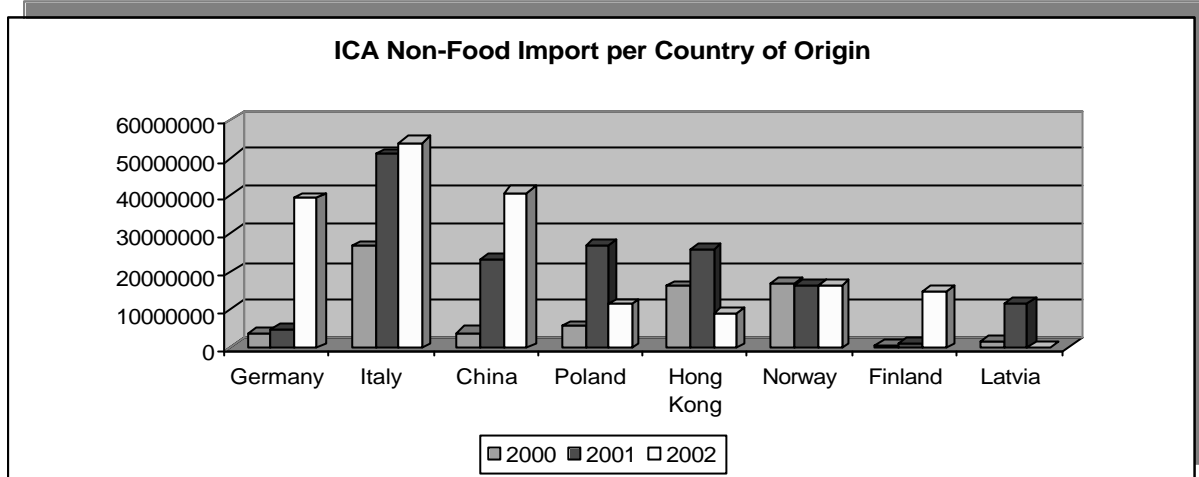


Figure 12, ICA Non-Food Imports per Country of Origin - Monetary terms

Source; ICA Internal Material

The sharp increase of sourcing activities in Germany is explained by the introduction of new private label within batteries (Novaline) and candles (Deco Design), where ICA Non-Food production has been located in Germany. Another interesting aspect is the steady increase of sourcing activities in China, and the sequentially stabilisation of import from Hong Kong. This can be explained by the reduced importance of trading organisations located in Hong Kong and a shift towards direct contact with suppliers in China. This will be further discussed when investigating the Chinese market potential in section 4.2.

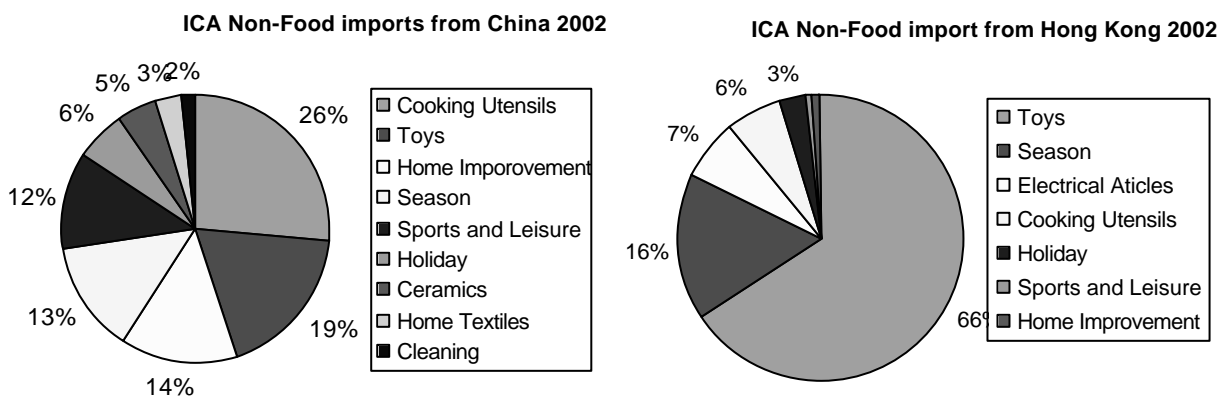


Figure 13, ICA Non-Food Import from China and Hong Kong 2002 - Monetary terms

Source; ICA Internal Material

As our study focus on the two markets of China and Latvia, it is interesting to investigate this more thoroughly. As shown in the graphs above the imports from China and Hong Kong are composed by a variety of product groups. An

important aspect to consider is that the ICA Non-Food's clothing and shoes products are not visible in the statistic as is a rather new product area and the statistics from the product groups is not yet available. However, a great part of the import within clothing and shoes derived from China. As the majority of Latvian import is constituted by charcoal this is not shown in a chart.

ICA Non-food has developed a competitive edge within non-food sourcing and especially within private label development. This is recognised by Royal Ahold and there are signs indicating that ICA Non-Food in Gothenburg might become the primary sourcing organ for the Royal Ahold group, which would dramatically increase their purchasing quantities as well as bargaining power. Mr. Moberg, CEO of Royal Ahold, has stated that coordination of purchasing activities within Ahold and its subsidiaries will lead to economies of scale and best practice within purchasing and sourcing has to be utilised.⁵⁹

4.1.3.1 ICA Non-Food Sourcing Strategy

ICA Non-Food is aiming towards reducing the steps between the company and its suppliers, thereby international sourcing is becoming an integral part of the company strategy. Rather than purchasing from Swedish suppliers and agents, ICA is becoming more internationalised and the amount of imports in real value has increased by 210 percent between 2000 and 2002. ICA's new strategy of trying to reduce the numbers of agents has proved to be very successful, and today many business deals are performed directly with the end producers. When using an agent the cost is between 3-5 percent of the amount of the order, which becomes quite costly in relation to the amount of import ICA Non-Food is conducting.⁶⁰

The overall goal of ICA Non-Food is to provide the end consumer with a wide selection of products for daily use at competitive prices hence, this puts lots of pressure on the sourcing department. According to Erik Törnqvist, Category Director ICA Non-Food, the increase of private labels is a direct response to ICA Non-Food's aim of providing stores with high quality products at a low cost. Though, in some cases private labels are rather a reactive than a pro-active approach as ICA is trying to cut the middle hand in transactions. This result in a broad range of generic brands, and these are better to collect underneath an umbrella name, i.e. ICA's private label. There is no other outspoken strategy

⁵⁹ Rydberg, Jonas, Purchasing Director, ICA AB, Stockholm

⁶⁰ Petersson, Stefan, Category Manager Kitchen & Home, ICA Non-Food

prevailing in regards to private labels except than to increase the proportion by one percentage annually.⁶¹

Similar to ad-hoc strategies concerning private labels there is no outspoken strategy when it comes to ICA Non-Food's sourcing activities. The independent Product Managers, responsible for different product group, develop their own sourcing solutions. These solutions differ widely between the product groups mainly dependent on the experience of the Product Manager as well as complexity of the product group. It is a clear trend that Product Managers with longer experience is conducting more sourcing activities further away from the Swedish markets and also engage in a wider spread of the sourcing activities. In other cases where the Product Managers have little experience, the sourcing activities take place on closer markets, often within the EU.

In addition to the Product Managers own experience, the product lifecycle within ICA also play an important role in the sourcing decision. If it is a new product, or a new private label, it is clear that the initial production takes place closer to the home market. One example of this is the newly introduced private label of candles where production currently takes place in Western Europe. The Product Managers are aware that it is not a financially optimal solution but it is important as a first step to get experience and to secure a risk free introduction of the product. As a second step the Product Manager will screen the global market for a more cost-efficiently solution and most probably locate production in Eastern Europe or Asia.⁶²

Concerning transportation almost all of ICA Non-Food's import from China, and most other countries from Far East is made Free On Board (FOB) which means that the supplier hands over the goods at the shipping port. However, ICA Non-Food takes care of the custom declaration when the goods enter the Swedish market. Therefore, the EU Enlargement will have a positive affect on trade in the case of custom declaration, as it will disappear after May 2004 between member countries.⁶³

⁶¹ Törnqvist, Erik, Category Director, ICA Non-Food

⁶² Lundin, Linda, Product Manger, ICA Non-Food

⁶³ Martinsson, Per-Ola, Logistics, ICA Non-Food

For any firm dealing on the international arena minimising the exchange rate exposure is of highest importance. ICA Non-Food has an existing system of forward contracts in order to reduce the exchange rate exposure as well as stabilise prices for the ICA stores. Six months in advance, the forward rates are presented to ICA's product managers, and these rates are valid for six consecutive months. ICA has a system of buying between 6-12 forward contracts per six months intervals depending on the estimated volume that will be paid out during the next coming period in respective currency. 80 percent of the estimating purchasing volumes of the respective currency will be covered by forward contracts, and the other 20 percent will be bought on the daily spot rate, hence is exposed to the fluctuating exchange rates. Hence, the product managers at ICA Non-Food do not base their purchase decisions on the spot rates presented in the daily paper, rather the forward rate that ICA bought their contract for a few months back.

It is clear that more transactions are being made in Euro as it is becoming a stronger and more stable currency, though, due to the recent fall of the dollar, many Euro denominated producers cannot compete with the dollar denominated Asian producers. As of today more currency exposures exist, even though ICA is engaged in preventative measures by buying forwards contracts, as the US dollar is fluctuating in larger spans against the Euro large uncertainties have evolved regarding the dollar value. In the coming chapter, a discussion will take place regarding exchange rate exposure and currency fluctuations of the Latvian Lat (Exchange rate as of 2003-12-05; 0,657Lat=1€) and Chinese RMB (Exchange rate as of 2003-12-05; 10 RMB=1€). These are small and unstable currencies and transactions between these countries and ICA Non-Food are done in Euro and US Dollar respectively.⁶⁴

4.1.4 Product Group – Home textiles

As previously stated, ICA Non-Food is divided into five main categories based on product type (see figure 11, pg. 45). Within Home products, one product group is Home Textiles, which will be further investigated in this report. ICA Non-Food has chosen to separate the Home Textile and the Clothing department and when speaking about Home textiles it is referred to textiles like towels, bed sets, curtains, down products, table decoration etc.

⁶⁴ Andersson, Dennis, Business Controller, ICA Non-Food

At present there are two persons working with home textiles within ICA Non-Food; Product Manager Christina Erikson and Purchaser Jaak Pugal. The product area of home textiles has been active for many years but in different constellations, and the current Product Manager has been managing the department since 2000. Christina Erikson has a previous experience from retailing within IKEA and has worked with home textiles for three years. Her background has given her a good knowledge about the retailing industry, as well as within the home textile area, and during her years at ICA Non-Food she has built up a network of suppliers and persons within the textile industry, which influences her in her purchasing and sourcing activities.

Today the Home Textile department imports almost all its products and work mainly with Swedish agents in their international sourcing activities, i.e. they deal with the foreign producer directly but a Swedish agent represents it. However, there is a desire to eliminate the agents in the sourcing process to be able to cut cost. However, the agents serve a very important purpose in the contact between ICA Non-Food and the supplier. When dealing with complex markets like India, China and Pakistan the role of the agent is vital because they assist in the regular contact with the supplier. Furthermore, by using agents ICA Non-Food get access to the collection of designs that the agent encompasses, which reduces the pressure on ICA Non-Food to develop own designs. The benefits of using agents are high but it has to be evaluated in relation to the cost. The home-textile department uses several different agents as they all have contracts with different producers in order to not be dependent on any single one, and also divides the sourcing orders between the agents.⁶⁵

The rise of private labels within the Home Textile product group occurred some years ago as a new brand named Deco Design was introduced in April 2001. The Deco Design brand is also used in ICA Non-Food's own production of candles and napkins. Within the Home Textile product group the sourcing activities are not dependent on any single market for products as many nations, especially in the Far East, compete within this segment. The only exception for this might be the down comforter that is very focused on China. The main sourcing markets for home textiles within ICA Non-Food are shown below.

⁶⁵ Erikson, Christina, Product Manager, Home Textiles, ICA Non-Food

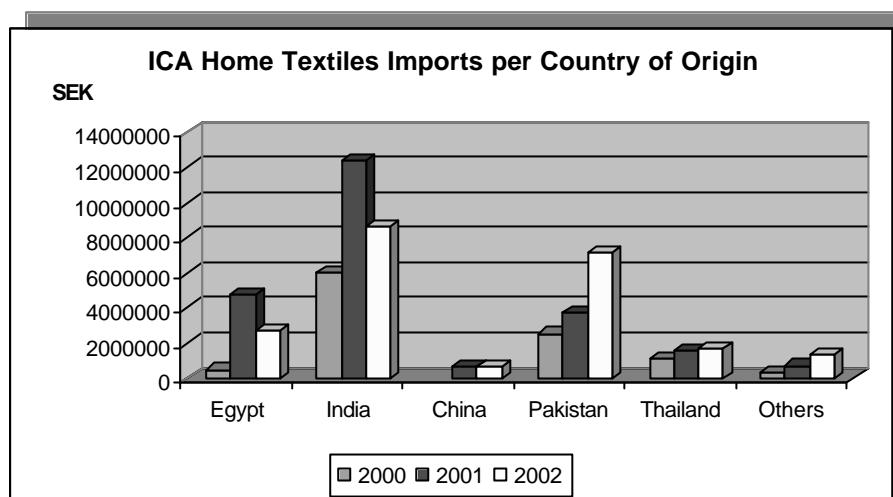


Figure 14, Home textiles per Country of Origin - Monetary terms

Source; ICA Non-Food Internal material

As shown in the graph India and Pakistan are the two main sourcing markets, followed by Egypt, Thailand, Sri Lanka and China. The import within home textiles is very irregular and unbalanced and currently the Home Textile department within ICA Non-Food is trying to stabilise and find a balanced sourcing solution. The motives behind the irregularity are the uncertainties prevailing on the sourcing markets concerning tariffs, quotas and non-tariff barriers. It is important to always be aware of political activities occurring on the global market affecting the textile sector, as textile products are very price sensitive and introduction tariffs and quotas quickly alter the competitiveness of the price, hence constant market screening must be conducted.

The deep decline of import from India and the sharp increase from Pakistan derived from a reduction of tariffs on Pakistan that increased the incentives to purchase from Pakistan rather than India. However, it is not only the economic rationale that is considered in the purchasing process. Another issue is the business culture among some supplier within the Indian and Pakistan markets that is an obstacle when conducting trade, sometimes on-time delivery etc., is not prioritised. Even if India and Pakistan are market leaders within production of home textile it is not always working sufficiently, and therefore it is of interest of ICA Non-Foods to investigate new markets. One example, stated by Category Manager Stefan Peterson, is the quality control of the factories producing ICA Non-Food products. In the case of Pakistan it is impossible for ICA Non-Food's representatives to travel to the market and investigate factories due to the unstable political situation. Quality control is one of the

cornerstones of ICA Non-Food's policies and therefore the current situation is unbearable in the long-term perspective.⁶⁶

Another issue of concern within the Home Textile department is the fluctuations of exchange rates that highly influence the potential for sourcing in different markets. This will be further developed in the presentation of both markets, where both Latvia's and China's exchange rates will be investigated in-depth. However, it is important to notice that ICA is securing its future exchange rates by exchange rate hedging. The previous fixed rate of Euro was 9,14 and today it is 9,18. In the case of US Dollar there has been a major change, from a previous fixed exchange rate of 10.80, and today it is levelled at 7,99 US Dollar. The consequence of this will be further analysed in the analytical chapters.⁶⁷

It is important to constantly investigate and screen for new sourcing solutions and take advantage of the dynamics of today's markets. Some of the Eastern European markets like Latvia have a tradition of textile industry which makes it of interest to research whether the accession to the European Union could improve its attractiveness of sourcing in term of reduces cost or other non-cost related factors.

4.1.5 The Global Textile Industry

The textile sector is one of the few labour intensive industries still having an important role in nations worldwide, both developed and developing. Textile industries are greatly dispersed and surrounded by much politics and protectionist actions, as it is quite sensitive to open competition. The total world export in 2001 amounted to 342 billion Euro, which is equivalent to 6 percent of world exports. The EU is the largest trader in textile and clothing products, in 2002 total trade amounted to 113 billion Euro. Within Europe, the textile and clothing industry is still a very important compositor of the GDP as well as a large employer. It employs about 2,1 million people (plus 0,6 million in the EU-accession countries) with a turnover of 200 billion Euro.⁶⁸ As the textile and clothing industry is fundamentally labour-intensive, the developing countries possess a competitive advantage in the industry because of the low wage costs. Europe is today trying to modernise and upgrade its industries, and

⁶⁶ Petersson, Stefan, Category Manager Kitchen & Home, ICA Non-Food

⁶⁷ Erikson, Christina, Product Manager, Home Textiles, ICA Non-Food

⁶⁸ International Textiles and Clothing Bureau (2003)

many activities (the more labour intensive processes) are being transferred to Eastern European and Northern African countries in order to achieve cost efficient production. Although, as the globalisation proceeds, many of the European textile producers fear the competitions especially from the Southeast Asian producers. Today, one third of all the textile and clothes bought on the EU market are imported goods whereof 1/3 (71,6 billion Euro) is enabled by quotas.⁶⁹

The world trade of textile is today dominated by United States and China, whereof China has the upper hand accounting for 10,2 percent in 2000 and 19,1 percent in clothing industry. Furthermore, China has the largest concentration of employment worldwide in the textile sector with six million employees. Many other Asian producers are of great interest as low wages enables them to be highly competitive, and in total the Asian producers accounts for 39 percent of world trade in 2000. For textile and garment manufacturing, the single most important cost driver is labour cost which not only makes it difficult for industrialised nations to engage in cost-efficient production, but it also segregates between first-generation and second-generation NIEs (Newly Industrialised Economies). The major advantage of low-cost producers, such as the Asian countries, resides in the production of standardised items, sold largely based on price, rather than fashion garments. When style and fashion are of higher importance, there is a tendency to situation production closer to the home market in order to minimise time-to-market.⁷⁰

Since the end of World War II, despite increasing trade liberalisation, the textile and the clothing industry have been the continuous exceptions from most trade liberalisation treaties. As industrialised countries with less competitive textile industry aims to protect their industries against the low-cost products offered by developing countries few incitements have prevailed towards creating free trade. Without tariffs and quotas much of the industrial world's textile production would vanish, as it is not competitive against countries such as China, India, Pakistan and Bangladesh etc. This explains why tariffs and non-tariff barriers have been immense in the industry starting with the Multi Fibre Agreement (MFA) in 1974.⁷¹

⁶⁹ ACTE, Action plan for the European Textile Industry

⁷⁰ Dicken, Peter (2003)

⁷¹ Kim Eng Securation (July 2001)

All nations within the WTO are today governed by the Agreement on Textiles and Clothing (ATC), which came into force along with the WTO agreement in 1995. ACT states that there will be a progressive phasing out of quotas established under the MFA agreement in the EU, US and Canada by 2005. During the period leading up to the phase out, there will be a successive increase of the quantity of quotas. However, this increase should have been initiated in 2001 but as China's membership in the WTO was not in session until December 2001, the decision on increase for 2002 was not set. During 2002 there were additional delays when the EU addressed the question of quotas along with market disruption and trade diversion. In the end of 2002 the quotas was therefore nearly unchanged and it was not until the beginning of 2003 that the EU Commission started to increase the quotas.⁷²

The purpose of the Agreement on Textiles and Clothing (ATC) was to develop the regulative framework surrounding the textile industry, by a progressive phase-out of quota restrictions over a transitional period of ten years (1 January 1995 through 31 December 2004). Unfortunately, instead of implementing the phase-out of quotas progressively, the members have left the majority number of quotas to be eliminated only at the end of the transitional period. Even after eight and a half years of implementation, the following numbers of textile quotas still remain in place: 851 out of 932 in the United States, 222 out of 303 in the EU, and 292 out of 368 in Canada.⁷³

Many speculations are now being undertaken whether complete abolishment will take place as well as what consequences this will have on the industrialised nations' textile industries. Furthermore, as China's WTO agreement includes many special clauses within textile, mostly negotiated by the US, there exists a clause stating that it is possible to carry on or introduce new textile quotas for four more years (until 2008). As US textile industry has a strong lobbying power, and they have presidential election next year, it is likely that they will try to keep their quotas towards China in regards to imported textiles. If the US initiates this action, the likelihood of EU following path is then quite high. Sweden has, in contrast to EU and the US, a quite liberal trade policy in most aspects, and before the EU membership quotas and tariffs were not used in the same extent as now. As the quotas will be taken away, it is very likely that anti-

⁷² Videll Annika (2003)

⁷³ World Trade Organisation (July 2003) (2)

dumping taxes, anti-subsidy taxes and safeguard measures will be imposed on import from many of the Asian nations.⁷⁴

Consequently, when the remaining quotas are abolished at the end of 2004, it is bound to exert downward pressure on prices. A sudden fall in prices is feared with the consequence of domestic industry in EU and US to state that is a question of dumping and putting political pressures for greater recourse to alternate forms of protection, like anti-dumping, anti-subsidy and safeguard measures. In this context, it may be noted that the industry interests are most likely to associate any declines in prices with dumping.⁷⁵

The system of bilateral quotas has frequently been accompanied by high tariffs applied on imports of textiles and clothing. Countries engaged in tariff reduction commitments during the Uruguay Round, but tariffs on textiles and clothing frequently remain significant even after the cuts, and as illustrated in Appendix I in the case of the EU, are on average considerably higher than in the manufacturing sector overall.⁷⁶

4.1.5.1 New Tools of Industry Protection

As explained above the EU and the US textile industry will be affected by the abolishment of textile quotas, and there are many speculations about the introduction of other protective measures against Asian competition. There are three possibilities of protective actions for EU to impose:

1. Anti-dumping

Anti-dumping measures can be undertaken if it is distinguished that a country is exporting products cheaper than it is selling on the domestic market. In this case an antidumping tariff can and will be imposed to adjust the prices to fair pricing. The tariffs are in some cases up to 30-40 percent, but vary largely depending on product group. The anti-dumping regulation was changed in 1997, after an anti-dumping measure imposed by EU against bed clothing from India. The WTO opposed and made an investigation and concluded that the calculation procedure of prices on the domestic market had been unfair to the exporting country, in this case India and this resulted in changes of the calculation system, which today makes it more difficult to prove an anti-dumping situation.

⁷⁴ Patek Stanislaw, Ambassador, Ministry for Foreign Affairs, Sweden, Stockholm

⁷⁵ World Trade Organisation (July 2003) (2)

⁷⁶ Organisation for Economic Co-operation and Development, OECD (May 2003)

2. Anti-subvention

The anti-subvention action can be undertaken when it is noted that a country gives subventions to domestic industries, which are not in accordance with WTO regulation (if subventions are given evenly to all producers in the same industry it can, in some cases, be acceptable according to WTO). If an anti-subvention tariff is imposed, the imports of the specific product from the specific market will be subject to a tariff of approximately 10 percent. However, the tariff can be divided differently to industries within the country, if a company can prove that they are not affected by the subvention, they are not obliged to the extra tariff, hence tariffs can differ within the country as in India.

3. Safeguard Measures

The third action that can be undertaken is the safeguard measure, which is a trade defence instrument to protect sharp increases of import of specific products into the European market. In this case a tariff can be introduced to protect domestic production from the increasing imports.⁷⁷ The safeguard measure is not that commonly applied but there are indications that the action could be more perceptible in the future, especially within the area of textiles. After the phasing out of quotas, the import of textiles to the EU will most probably increase sharply, which could motivate the exercise of safeguard measures.

The exercises of the three above presented tools of industry protection is a complex administrative process within the EU Commission, and the procedure from a notice to a decision can take around 13 months. However, before an investigation, the case of examination is presented on the in the EU Official Journal. The potential of the introduction of a tariff after a process is very high and most companies subject to the import tariff usually start to look for new suppliers on new markets as soon as an investigation process is initiated.⁷⁸

4.1.5.2 Future Concerns in the Textile Industry

The new market conditions within the textile industry governing after 2005 will lead to intensified competition, whether new trade barriers will be created or not. Some countries currently prominent in export will become less important and the winners will most likely be the countries having a complete textile

⁷⁷ Detlof Helena, Specialist Antidumping, National Board of Trade, Stockholm

⁷⁸ *ibid.*

value chain available within the nation, i.e. availability of raw cotton, knitting, colouring and sewing. This makes countries such as Pakistan, India and China well equipped for the future. In regards to the markets in Europe, the future is limited. It is slowly moving upscale in the price levels. Portugal which previously has been the dominating textile country has become very expensive, rather the Baltic States have taken their role but they also face a limited future as a cost competitor. Turkey, which also has a prominent textile industry, is similarly facing higher factor and wage levels making it difficult to compete with the Asian producers.⁷⁹

Furthermore, China was approved on special treatment in its WTO membership, which includes that China, will not be regarded as a market economy during the coming 15 years. This implies special handling of, for example, the anti-dumping measures and the Chinese price on a product will not be regarded as representative for a market economy and therefore compared to a third country. The problem is that it is difficult to receive information on prices and price calculations from companies in a comparable country. As a consequence, US use domestic companies as comparable for a third market, which puts China in a difficult situation and high anti-dumping tariffs, are implemented.⁸⁰

According to a recent survey conducted by OECD, analysts estimated the overall benefits and future effects of the phasing out of quotas according to the MFA agreements. Their conclusions are only broad assumptions and take a wide range between annual global benefits of 6.5 billion US Dollar to 324 billion US Dollar, but it is clear that textile and clothing production will move from developed to developing countries. All studies indicate that Asia will experience the greatest change in the distribution of production. Quotas, anti-dumping and anti-subsidy have yet provided protection for higher cost producers, and abolished quotas will be the first step towards a market driven system. Of the Asian countries, China holds the greatest future as it has a very large low cost labour force, existing and extensive textile industry and it can benefit from the knowledge of Hong Kong's financial and marketing experts. Today China holds about 1/5 of total apparel market. If similar developments will occur in 2005 as it did in 2002 after the 3rd stage of ACT, predictions are

⁷⁹ Patek, Stanislaw, Ambassador, Ministry for Foreign Affairs, Sweden, Stockholm

⁸⁰ Detlof Helena, Specialist Antidumping, National Board of Trade, Stockholm

that China will enjoy a 150 percent increase in its textile and clothing export, and account for 50 percent of the world market after MFA phase-out.

Regarding the future of India and Pakistan, the views are conflicting, they may lose some production to China, but they will also take some from small producing countries. India and Pakistan have a long tradition within textiles, and especially Pakistan has very modern industrial parks for production.⁸¹ According to agents working on the world market of textile, they are certain that both India and Pakistan will remain important sourcing markets in the foreseeable future as they have long lasting history within the textile sector, especially concerning home textiles. India will face difficulties in a long run as their industrial park is fairly old and will in the future require updates. Still, that enables them today to keep low prices as it is completely paid off.⁸²

Europe is trying to further enhance its domestic textile industry in order for it to survive the intensified competition and the new market conditions after 2005. ACTE (Asociación de Colectividades Textiles Europeas), which represent the largest textile producing regions in Europe, has proposed five pillars for future value added activities; Fashion and creativity, Product quality, Quick response, Technical textiles and Health textiles. Europe wants to move further in the value chain and produce textile products subject to more advanced technologies or fashion sensitive. Europe is today a net importer of textile goods and as the quotas will be phased out until 2005 precautionary measures, like previously mentioned, must be taken in order to not be swept away by Asian low cost producers.⁸³ In this way the European countries have the potential of finding their competitive advantage in the textile industry, instead of competing with highly cost-efficient countries in Asia. China is one of the most cost-advantageous markets today and has a great potential in the future textile industry. It is today one of the main exporter of textiles which makes it of utmost importance to investigate the current situation in the country and the future potential of sourcing activities.

⁸¹ International Textiles and Clothing Bureau (2003)

⁸² Magni Robert, Sales Manager, C. Jahn AB

⁸³ ACTE, Action plan for the European Textile Industry (2002)

4.2 China

As mentioned in previous chapter China is one of the most powerful actors within the textile industry and its potential spans throughout several other industry sectors. China is developing to become a world factory and a major global player, both economically and politically. Its immense geographical size creates huge potential in exploiting its vast resources, most specifically its low-cost labour. This chapter will present an overview of the political, economical and industrial situation of China, put into the context of sourcing opportunities. The presentation will emphasise on aspects of interest in sourcing in order to access the present and future potential of China as a sourcing market, which could imply that a number of otherwise important aspects will be left out to leave room to a stricter focus on sourcing.

4.2.1 *Political Situation*

The history of China's political system is one of the most studied and debated worldwide. It is the major factor influencing the Chinese society and culture, and a cornerstone for understanding the business culture. However, the complexity of the politics is immense, hence difficult to describe shortly without sounding banal. Therefore some highlights in past political issues will be briefly described in this chapter combined with present and future political aspect of China in order to access business and market potential.

4.2.1.1 **The Government of China**

The key influencer in Chinese political society is Mao Zedong and his philosophy. In Beijing, October 1st 1949, Mao Zedong announced the founding of the People's Republic of China, which was the initiation of the Chinese society as it is today.⁸⁴ Since that day, China has been characterised as an authoritarian communistic society sheltered from the outside world. The population has been suppressed, still numerous protests have arisen, mainly deriving from social inequalities and a belief that the government neglected the interest of the people, i.e. not fulfilling its promises of increased living standards. The Great Leap Forward and the Tiananmen Square Massacre are two occasions that has deeply impacted the Chinese society and will remain long lasting memories of the people.⁸⁵

⁸⁴ Wikipedia Homepage

Today the Communist party is still the sole party in power in China and has around 60 million members. The Communist Party of China (CPC) is stated to adhere to Marxism-Leninism and Mao Zedong thoughts combines with Deng Xiaoping theory as the guidance of its actions.⁸⁶ The highest leading body of the Communist Party of Congress China is the National Party Congress, which is held once every fifth year.⁸⁷ The most recent was held in Beijing in Mars 2003, which enabled the new President, Hu Jintao to assert more control over the CPC, as he attempts to step out of the shadow of his predecessor, Jiang Zemin. He is pursuing plans to increase the debate and political participation within the Communist Party and among other plans to provide legal protection for private company property. Stability and cautious reform will be the key policy of Jintao rising to power in an era of modernisation, and having a personal stake in maintaining gradual reform.⁸⁸ The unquestionable control of the country that the Chinese Communist Party (CCP) today enjoys means that it is “politically stable,” though sometimes in a questionable manner - any political opposition is usually dealt with promptly. However, in a long-term perspective, political stability rests squarely on economic progress; if the economic situation deteriorates, social unrest may become a factual problem.⁸⁹

China is divided into regions and these administrative units are currently based on a three-level system dividing the nation into provinces, counties, and townships. It is important to be aware of these regional divisions in Chinese politics as the local regulation is receiving more importance. Many new policies are derived from local level but being decided upon on national level, this sometimes even if it only relates to the local district.⁹⁰ China's regions have become responsible for a wide range of functions that previously were under the control of the central government, though still under close watch of the national government.⁹¹ The division of power in China is very complex and confusion often arises due to the unclear line between regional and national institutions.⁹²

⁸⁵ Wikipedia Homepage

⁸⁶ China Internet Information Centre Homepage

⁸⁷ Ministry of Foreign Affairs in the Peoples Republic of China Homepage (1)

⁸⁸ China & North East Asia Monitor (2003)

⁸⁹ World Market Analysis, Country Report China

⁹⁰ Jiang Caroline, Industry Dept. project Manager, Shanghai Foreign Investment Development Beard, Shanghai

⁹¹ World Market Analysis Database – Country Report China

⁹² Ministry of Foreign Affairs in the Peoples Republic of China Homepage (2)

4.2.1.2 Current Governmental Concerns

China is today one of the few markets where communism still is exercised and it can be claimed that it is today one of China strengths. The immense size of China and the huge and increasing discrepancies in economic and social standards throughout the country makes it complex to handle by more than one hand. Many nations stress for implementation of a Chinese democracy, which in the future is a must, but it is of utmost importance that the transition towards democracy will be a step-wise process to avoid social unrest.⁹³ But, as stated by Mr. Lennart Petzäll, Manager of Cathay Consulting, there is a communist party in China but China is not a communistic state. The view on capitalism and money is embedded in the Chinese culture and according to Mr. Petzäll “China is one of the most developed capitalistic states in the world as most anything can get bought if having the money”.⁹⁴

Today, China is committed to economic reform and liberalisation of its previously sheltered society. The Chinese leadership has addressed reformation of state industries and establishment of a social safety network as governmental priorities. Governmental strategies for achieving these goals include large-scale privatisation of unprofitable state owned enterprises (SOEs) and development of a pension system for workers. However, political change is still seen as a taboo topic but the overall trend is clearly towards liberalisation. As a political freedom is achieved economic liberalisation may also follow path, but the speed of progress is likely to be slow.⁹⁵

4.2.1.3 Legal Aspects

The political situation of China, though considered stable, is very uncertain in its carrying out of legislative power. It is difficult to see the division of responsibilities between authorities and legal matters are sometimes solved in questionable manners. According to the constitution the Chinese Courts should be independent and non-political, although, the political influences in the courts are immense. There are numerous cases where the CPC has had an important role in case rulings, both on local and central level. Measures have been taken to limit corruption in the court system. In 1999 it was decided to open up the courts to the public with the exception in delicate cases.⁹⁶

⁹³ World Market Analysis, Country Report China

⁹⁴ Petzäll Lennart, Consultant, Cathay Consulting Ltd. Shanghai

⁹⁵ World Market Analysis, Country Report China

The opening up of the Chinese economy along with the membership to the WTO has put immense pressure on China to improve its legal system. In 1999 the Chinese Government created a “WTO Leadership Team” which main concern was to prepare for the Chinese membership in the WTO in legal aspects. In August 2001 it was announced that 2300 laws and regulations had been taken away or re-formulated resulting in a very turbulent legal environment.⁹⁷

The major problem concerning the regulatory framework is not that the government fails in constructing policies but that the local politicians differ in its implementation of the policies. Local politicians are getting stronger and, captivating power of the central government, which further creates a competitive situation between the regions.⁹⁸ According to Mrs. Caroline Jiang, Shanghai Foreign Development Board, the problem international companies experience in China is not the lack of legal framework, rather the continuous changes within. It is important to establish a contact with people and organisations that follow these changes in order to take advantage of the dynamics in the regulations.⁹⁹ Today China experiences a sharp increase in establishment of industry associations that put pressure on the government to formulate regulation in accordance to the demands of Chinese business. The association also serves the purpose as an important source of information concerning legislation.¹⁰⁰

4.2.1.4 Corruption

It is very hard to determine the spread of corruption in China as many borderline activities are embedded in the Chinese business culture, in the concept of Guanxi, which means something like relationship/friendship. In China it is important to establish a well functioning personal network. Consequently Guanxi can stimulate corruptive actions because if one experience Guanxi to someone one have certain cultural bonds to this person, which can lead to irrational decision when conducting business. However, it would be ignorant to state that Guanxi is not present in other cultures, but it is not as widely accepted or spread. According to a WTO report on Chinas

⁹⁶ Videll Annika (2003)

⁹⁷ *ibid.*

⁹⁸ Zhang Charles, Manager Commodities & Trade Finance and Sales, Australia and New Zealand Banking Group Limited, Shanghai

⁹⁹ Jiang, Caroline, Industry Dept. project Manager, Shanghai Foreign Investment Development Board

¹⁰⁰ Hähnel, Fredrik, General Manager – East China, Swedish Trade Council, Shanghai.

membership in the WTO it is stated that the Chinese legal system and the transparency in the market is rather good compared to other developing nations.

4.2.1.5 Human Rights & Health

During the first months of 2002 the Chinese economy showed remarkably good signs, though it was quickly disrupted in April when SARS became a public issue. The retailing and service sector were severely hit and the outbreak of SARS provided a set back for the rapid growth enjoyed by China.¹⁰¹ However, no effect on the long-term economy is visible, though China has received lots of criticism worldwide for its initial handling of the situation as they tried to convey the extensiveness of the outbreak.¹⁰² There are speculations that SARS today is laying latent and a new outbreak can take place. The Chinese government as well as other Asian governments take this seriously and precautionary measure is taken in order to limit the extensiveness of a potential new epidemic. If a new outbreak, it will once again provide a set back in the growth figures, put factories in quarantine and create an unstable situation for businesses and people.¹⁰³

In addition, China is frequently accused of human rights violations. Issues such as freedom of religion and freedom of speech, as well as minorities' rights, are a hot issue in China as many international governments as well as organisations claims that they are being violated.

As presented above numerous political actions are implemented in China as it is going through its transition towards a market economy. Because of the immense size and its disparity between regions, political policies are in very close connection to economic reforms. The strong ruling by one party makes it possible to attain strong political control over financial aspects as long as the people of China are pleased with their social situation.

¹⁰¹ World Market Analysis Database

¹⁰² Swedish Trade (2002), Country Report; China

¹⁰³ Balfour, Frederik & Roberts, Dexter (2003)

4.2.2 *Economical Aspects*

China is today an economy travelling the fast lane to economic prosperity. Since the opening of its economy to the outside world it has enjoyed a steady path in its economic transition. Between 1978 and 1998 China has experienced growth figures at a steady rate around 8 percent, which puts it in a position as the fastest growing economy in world history.

China is continuously attracting increasing levels of FDI, which further enables its economic growth. It has become the world manufacturer and soon it will probably begin its own Research & Development (R&D) and value added activities to a larger extent. Along with the accession to the WTO, China has agreed to undertake several market driven activities and policies, which will further improve the businesses environment. Many economic aspects look very bright in the future of China, though there are some dark clouds. Some claim that China is growing too fast, and is producing too much, with the consequence of over production. In addition discussions prevail regarding a potential real estate bubble, which if it burst could have similar painful consequences as the savings and loan crises in the US in the 80's.¹⁰⁴ Also, the amount of non-performing loan is still dangerously high which puts pressure on an already suppressed bank system and the environmental conditions are worsened. Still, as a result of the extensive investments made by local companies as well as governmental agencies China's economy grew at an official 8.5 percent annual pace for the first three-quarters, which might in actual numbers be even higher.¹⁰⁵

4.2.2.1 Governmental Strategies

Previously the government has been focusing on rapid growth and attracting as much FDI as possible. China has pursued an expansionary fiscal policy since 1998 in order to stimulate consumer spending, focus has been on infrastructure, support of SOEs and pay raises for civil servants. The current strategy is attaining the sustainable growth that has been created during last five years. This is shown in for example environmental concerns, creation of green areas in the inner cities and the increasing economic attention given to the western and central parts of China. There is an indirect contract between the people of China and the government, which states that as long as the government can provide enhanced living standard and economic growth to the people they can

¹⁰⁴ Balfour, Frederik & Roberts, Dexter (2003)

¹⁰⁵ *ibid.*

stay ruling. Although, the central and western part of China are at least 50 years behind in economic development and as a consequence much governmental resources has been allocated to these regions in order to attract investments within.¹⁰⁶ Today the government relies on its huge dollar resources, trade surplus and large level of FDI inflow to finance its large public spending, but it is aware that increased fiscal spending is unsustainable in the long term.¹⁰⁷

4.2.2.2 Macro Economic Figures

The GDP (Gross Domestic Product) growth realised in China is quite impressive in its figures. Though, it can be questioned, how much of this is actual real growth and how much is stimulated by local and state officials as well as accounting mistakes. Today more than 50 percent of GDP is made up by governmental enterprises in the steel, petrol, coal and telecom business. Reforms are being implemented to make state owned companies into public owned companies and list them on the stock exchange. The risk momentum in this aspect is that SOEs, even if not producing profit, is employing large amounts of the population, hence as the privatisation proceeds, the risk of raising unemployment surge.¹⁰⁸

In GDP measured in purchasing power parity, China constitutes the second largest economy in the world, next after the United States. Divided on the population, the PPP (Purchasing Power Parity) of GDP per capita is only 4475 US Dollar compared with the US level of 34919 US Dollar.¹⁰⁹ The GDP growth is very unevenly distributed, as well as the income and earnings. To give an example, the average GDP per capita in China in 2002 was RMB 8184, whereas the richest cities; city of Shanghai and Beijing has a GDP per capita of RMB 40 646 and 28 449 respectively.¹¹⁰ Hence China is becoming a society with great inequalities, the richer are getting much richer, while the poor are becoming less poor which is clearly viewed in the graph on next page. The Gini Coefficient rates nations from 0 to 1, 0 representing perfect equality and 1 total inequality. According to the Gini coefficient China scores 0.4 in 2002, a rise

¹⁰⁶ Zhang Charles, Manager Commodities & Trade Finance and Sales, Australia and New Zealand Banking Group Limited, Shanghai

¹⁰⁷ World Market Analysis - Country Report China

¹⁰⁸ Zhang Charles, Manager Commodities & Trade Finance and Sales, Australia and New Zealand Banking Group Limited, Shanghai

¹⁰⁹ World Bank Homepage (1)

¹¹⁰ China's statistical year book 2002

from 0.25 in 1984 and 0.38 in 1992.¹¹¹ This can be put in comparison with the US 0.34, which typically is classified as unequal society.¹¹²

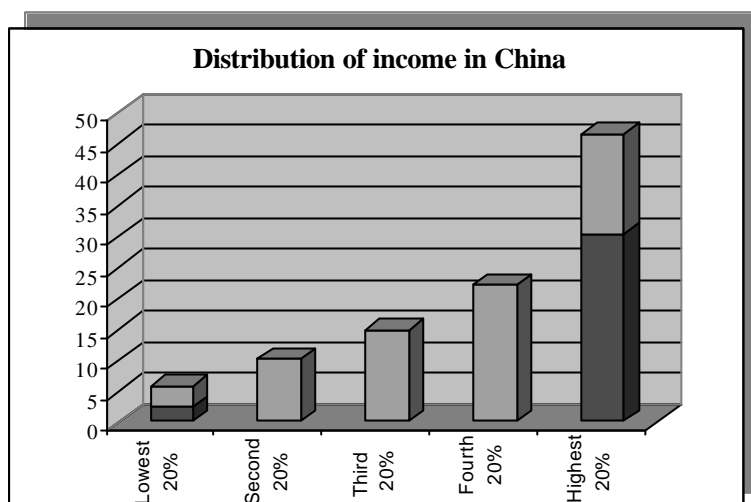


Figure 15; China Income Distribution 1998

Source; World Development Indicators, World Bank 2002

As seen in the Figure 15, the income distribution in 1998 is graphically shown, both in 20-percentiles, as well as separating the income and consumption of the 10 percent richest and poorest (the darker part of the bar). It can be seen that the richest 10 percent of the population account for 30 percent of total income whereas the bottom 10 percent accounts for 2.4 percent. It is visible that the overall economic prosperity has been enhanced as well as purchasing power, though the disparity between the rich and the poor as well as urban and rural population is increasing. The figures are not up to date as no recent survey has been conducted. What can be stated is that the richest 20 shares has proportionally increased their income and consumption share at a higher rate than the lowest 20 percent bracket.¹¹³ This can be seen in the overall household consumption that in total increased 43,5 percent from 1996-2002 whereas the largest portion, 46.8 percent derived from urban households compared with a 27,8 percent increase of rural households. Furthermore, urban consumers account to 39 percent of the population and the ratio between urban and rural consumption is 3,6.¹¹⁴

China has been fighting deflationary pressures within the economy, i.e. the overall price level within the nation is decreasing. Positive figures incurred in 2003 as China for the first time following 12 months of consecutive deflation

¹¹¹ World Bank Homepage (2)

¹¹² Clifford Mark (2002)

¹¹³ World Bank Homepage (3)

has enjoyed price increases. The IMF is estimating 2003's inflation to remain low, but at a positive figure of 0,2 percent and next year 1,2 percent.¹¹⁵

As seen in the graph to the below, negative consumer price index, i.e. falling prices on consumer goods have occurred in China throughout the last couple years, which is no indication of a healthy economy.

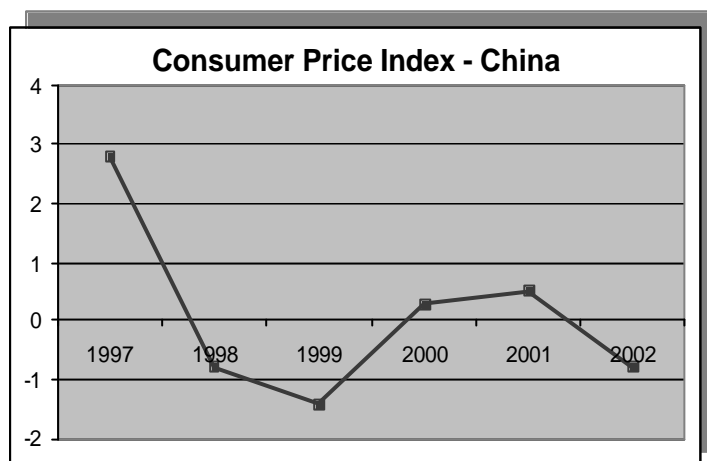


Figure 16, China Consumer Price Index 97-02
Source; World Economic Outlook, IMF April 2003

Inflation remains subdued in China mainly depending on the mal-functioning financial system, which grants loans to SOEs that in their turn creates overproduction and consequently price pressure. The problems are most pronounced in the auto, steel and property sectors of the economy, but the growing urban unemployment impose further downward pressure on prices by reducing consumer demand.¹¹⁶

4.2.2.3 Exchange Rate Risk

Today, it is much discussion concerning the Chinese currency, and whether it should float or revalue. The exchange rate arrangement is a managed floating system by the People's Bank of China (PBC), which quotes spot rates of RMB (Yuan) against U.S. dollars, Japanese yen, and Hong Kong dollars on a daily basis. The rates are calculated as a weighted average and exchange rates of RMB against other foreign currencies are calculated by commercial banks based on the cross-rates between RMB and US Dollars at the rate of 8.28.¹¹⁷ The government has reserved the right to engage in minor modifications around this point. Similar to the RMB, Hong Kong has for 19 years remained a fixed

¹¹⁴ China's statistical year book 2002

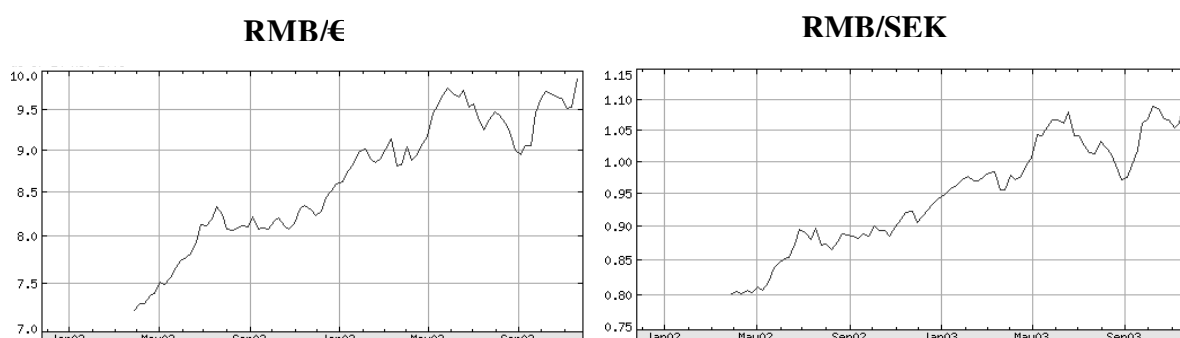
¹¹⁵ IMF (2003) World Economic Outlook

¹¹⁶ World Market Analysis, Country Report China

¹¹⁷ International Monetary Fund (IMF) Homepage

rate of the Hong Kong Dollar to the US Dollar. Last year, 2002, they reaffirmed their peg at 7,80 HK Dollar to the US Dollar. Upon reaffirmation extensive criticism was received as Hong Kong exports suffered, the previous high dollar value made Hong Kong's export more expensive than those of Asian competitors like Taiwan, whose free-floating currencies had fallen against the dollar that year. However, today with a falling US Dollar, the situation is reversing.¹¹⁸

The IMF is pushing the Chinese government to introduce a more flexible exchange rate system, but the Chinese Central Bank has rejected the proposal referring to worries of inflation and drastically raising prices. The government is planning on letting the currency float, but at least not until 2007 and with the introduction of a stepwise process. As of today, not everyone can trade with foreign and domestic currency, one need approval from the government, and if receiving foreign currency this must be exchange into Chinese RMB within 2 weeks.¹¹⁹



**Figure 17: Exchange Rate Fluctuations RMB/€ and RMB/SEK,
Source; Yahoo Finance**

Due to China's peg to the US Dollar the RMB is closely following the dollar fluctuations on the world market. As seen in the two graphs above, the influences of the reduced dollar value is apparent in the trading value of RMB against the Euro and SEK. Due to recent slowdown in the US economy, and the consequent reduction of the dollar value, China, though enjoying a rapidly growing economy, has indirectly weakened its currency. Due to China's peg to the US\$ the RMB is closely following the dollar fluctuations on the world market. This has created a favourable export position as the RMB has decreased in value to many important currencies, Euro and SEK as seen above, and this through an economic slowdown in the US, not in its own country.

¹¹⁸ The International Herald Tribune Homepage

¹¹⁹ Zhang Charles, Manager Commo dities & Trade Finance and Sales, Australia and New Zeeland Banking Group Limited, Shanghai

Many parties, especially US interest groups are pushing for a revaluation of the RMB as present value may not reflect actual value. Presidential elections will be held in the US next year, and as US incurred a US Dollar 100 billion trade deficit with China in 2002 along with raising manufacturing unemployment, calls are growing for the US to impose trade sanctions on Chinese goods, unless the RMB is allowed to revalue.¹²⁰ Some analysts claim that the RMB is about 40 percent undervalued. Reluctance from Beijing to interfere is driven by the fear for slope in export, which ultimately will lead to worsening conditions in the dysfunction banking system. As of today, due to the weakening US Dollar, China has experienced a favourable position in international trade compared to other Asian nations especially Japan and South Korea. But, as the dollar is fluctuating in large intervals, it enhanced the interest rate exposure when conducting international trade.¹²¹

The Chinese economy, and especially the discussion of the exchange rate, is influencing several aspects of China's development, and particularly the context of trade and industry development. Fluctuations in the exchange rate is, as mentioned above directly influencing the potential for export and imports, hence it is important to understand the exchange rate situation and when further analyse the current industrial situation of China.

4.2.3 Industry Development

China is today a world manufacturer, almost anything can be produced within the country and the technology and quality of products is rising. The agriculture sector, which was the first sector to open up is today underdeveloped and has been surpassed by the secondary and tertiary sector. The manufacturing is of utmost importance and it comprises 49 percent of total GDP. SOEs still comprises about 50 percent of the output, although they are undergoing reformation in order to privatise and rationalise as many are operating with consecutive losses. The most important sectors, within manufacturing, for SOEs are steel, refrigerator, textile and garments and refining.¹²²

China has succeeded in its industrialisation process aided by extensive utilisation of special economic zones and strict regulation adhering. It has relied upon FDI as a source of income as well as transfer of know-how and

¹²⁰ China & North East Asia Monitor (2003)

¹²¹ Cooper James & Madigan Cathleen (2002),

¹²² Balfour Frederik & Roberts Dexter (2003)

knowledge for its own development. China was in 2002 the world's largest recipient of FDI, and it amounted to 52.7 billion US Dollar. However, investments are sometimes re-routed through Hong Kong in order to enjoy similar tax benefits given to foreign firms, hence the FDI might be somewhat overstated.¹²³ The allocation of FDI is unevenly dispersed with the rich and developed east coast receiving the greater part.¹²⁴ As a part of the government's new program they are offering favourable incentives to invest in the western and central regions, as of yet the results are not overwhelming. The Ford Motor Company has succeeded with an investment in the inland in Yangtze, and nowadays a cluster has been created around the auto plant.¹²⁵

Today, almost all S&P500¹²⁶ companies have presence in China through some sort of investment. Most companies see it as a requirement for survival to exploit the Chinese market.¹²⁷ According to WTO statistics, China has advanced to the fifth place in world merchandise trade, it increased 20 percent in 2002, and forecasts states that China's role as a manufacturer as well as importer will further increase; office equipment, electric machines, clothing and toys are dominating the export.¹²⁸ One of the main problems in China is that there exist too many producers, as well as surplus of products, which both leads to price pressures as well as difficulties to establish the quality and trust of the supplier for an inexperienced purchaser at the Chinese market.¹²⁹ Things are not always as they first tend to be in China, i.e. a large company with many employees is not necessarily a stable successful company rather sometimes on the verge to bankruptcy, it is therefore important to always look at the details of firms in China.¹³⁰

Today there are five major tax preferential zones in China; Guangdong Province, Fujian Province, Hainan Province, Hunchun, Pudong Development Zone (Shanghai). The aim of these programs is to encourage foreign investment in China, bring jobs, technical knowledge, and future tax revenues in return for significant tax concessions at start-up of the operations. Most often

¹²³ World Market Analysis, Country Report China

¹²⁴ Roberts, Dexter (2000)

¹²⁵ Nilsson Sofie, Information Manager, Swedish Trade Council, Shanghai

¹²⁶ Widely regarded as the best single gauge of the U.S. equities market, this world-renowned index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. More info at www.standarpor.com

¹²⁷ Yan, Frank, Market Consultants, Swedish Trade Council, Shanghai

¹²⁸ World Trade Organisation Homepage

¹²⁹ Peterson, Jonas, Chief Representative, Åhlens Far East in Shanghai,

¹³⁰ Zhu, Paulo, President, Hangzhou Samsung Down Products Co., Ltd, Hangzhou

the first five years are 100 percent tax-free and the next coming five year's earnings are most often taxed at a reduced rate, often 50 percent. Depending on what industry the local or state government aims to develop, various zones are established in order to create cluster synergies.¹³¹ This is a severe problem when it comes to the opening up of the Chinese market as it is disrupted by protectionist actions by some Chinese regions.¹³² A problem prevailing is that local officials sometimes try to overdo each other in the provision of the best business climate to fight for increased FDI. China's National Development & Reform Commission stated in its September report that "GDP growth is actually used as a way to evaluate local officials, and that motivates unreasonable investments."¹³³

China is today trying to strengthen its position within IT, Telecom, machinery and environmental protection. In order to do so, favourable investment climate is created for foreign firms wishing to invest in these sectors, and much investment is received. Domestic firms are also growing within this sector. These sectors are largely situated on the east coast, which is by far the most developed region in China. As the central and western regions have enjoyed little economic prosperity much of the labour intensive production is slowly moving out to the countryside, supported by the government who invests heavily in infrastructure and education within.¹³⁴ Today international standards such as ISO certifications are getting more common, which legitimises the factories' quality work.¹³⁵

4.2.3.1 Textile Industry in China

As China is one of the main actors in the global arena within the textile industry, much of China's textile industry has been mentioned in previous chapter 4.1.5 when describing the global textile industry. However, there are some country specific concerns that will be further explained below. China is today a dominating market in textiles, and especially in clothing. It is today somewhat restrained by the strict quota policies that are applied on many of their products. The textile industry remains one of the largest exporting industries accounting for 20,9 percent of the total export.¹³⁶ In June 2001, the

¹³¹ China Unique Homepage

¹³² Videll, Annika (2003)

¹³³ Balfour, Frederik & Roberts Dexter (2003),

¹³⁴ Yan, Frank, Market Consultants, Swedish Trade Council

¹³⁵ Liang, Eugene, General Manager Canton Fair Import & Export Co. Ltd, Guangzhou

¹³⁶ Kim Eng Securation (July 2001)

State Economic and Trade Commission of China announced details of its 10th Five-Year plan. The 13 industries included in this plan are the most important industries in China's economy, including among others auto, metal, pharmaceuticals and textiles. In 2000, China had 18 900 registered companies in the textile sector. Over 80 of them were listed and 159 companies maintained more than 30 million annual exports. During 2000 the export of textiles from China reached 52,08 billion USD which accounted for about 13 percent of the world trade in textiles and garments.¹³⁷

The weakness of Chinese textile industry is above all the lack of development of technological advancements. Production of low-end goods attracts most competition while export dominates by products without their own labels. It is also important to consider the raw material in the downstream operations. Low flexibility and adaptability to changes in world price of cotton is still apparent. In addition, licensing policy for wool also restricts imports from Chinese producers. There are also regional differences in the production of textiles and garment with focus on the eastern parts of China. The volume of garment produced on the western part represent only 2,3 percent of total production.

As stated before, the MFA Agreement on textiles and garments is also supposed to be phased out and terminated by 2005. However there are voices raised by many producers in China that a full liberalisation of the textile industry is impossible to be fulfilled in 2005. As China is phasing out of the MFA agreement there are several thoughts that other barriers to trade will be imposed to Chinese textile and clothing products. These may include additional tariff barriers, further focus on human rights, codes of conduct and environmental considerations.¹³⁸

However, it must be stated that China is not the single actor on the world textile exporter. Lower cost production is still prominent in Pakistan, Bangladesh and especially India. India has during the research been observed as a highly competitive market and in many cases a better sourcing solution than China. However, many of the issues concerning Chinese textile industry are applicable to most Asian markets, and no further investigation will be conducted on the Indian market. In addition China with its immense size and potential can be regarded as highly competitive within textiles in a future perspective.

¹³⁷ Kim Eng Securation (July 2001)

¹³⁸ *ibid.*

4.2.3.2 Human Resources

Much of China's competitive advantage derives from its abundant labour force ranging from cheap low-skilled workers to highly trained scientist and engineers. By having a diverse workforce, labour cost will remain competitive in the foreseeable future, though labour intensive production will undergo a shift westwards while the east coast in the future will enjoy more value-added activities and production. To give an example, rural per capita income is RMB 1,123 (US Dollar 136), compared with RMB 3,942 (US Dollar 477) in urban areas.¹³⁹ Today problems exist in the labour mobility, many workers are migrating from the poor rural areas to larger urban areas and in many cases they cannot all be absorbed by the economy. In Shanghai for example, this has been a big problem and nowadays one needs a "green card" in order to move into the city and work.¹⁴⁰ As a response to the growing economy, wages have followed path as shown in the graph below, though unevenly distributed.

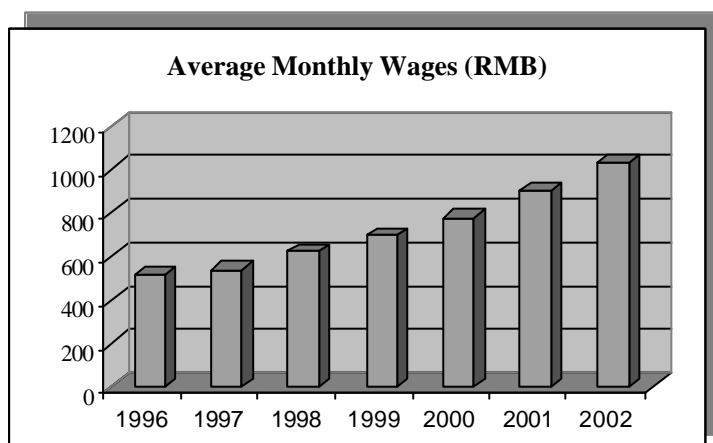


Figure 18; Average Monthly Wages in China

Source; China's Statistical Yearbook

As seen in the graph above average monthly wages have doubled between 1996 and 2002, and according to China's statistical bureau the average annual wages in 2002 equalled to an average of RMB 12422.¹⁴¹ Unemployment has been increasing as a result of the restructuring of SOEs, and the private sector has been unable to absorb these workers. Today the official unemployment rate is about 4-5 percent, however the unofficial figure can be as high as 20 percent.¹⁴² In the first three months of 2003 the official unemployment rate reached 4,1 percent, which was the highest registered unemployment in 22 years, which was explained by increasing numbers of graduating students and discharges

¹³⁹ Business Week, Bankrupt Logic About China's Debt, November 22, 2002

¹⁴⁰ Jiang, Caroline, Industry Dept. project Manager, Shanghai Foreign Investment Development Board

¹⁴¹ China's Statistical Year Book 2002

¹⁴² Nilsson, Sofie, Information Manager, Swedish Trade Council, Shanghai

within state owned companies. In last five years 27 million people have been discharged from SOEs in China.

However, the outspoken aim of China is to keep the open unemployment rate below 4,5 percent.¹⁴³ In addition, urban unemployment is forecast to rise significantly during the initial years of China's WTO membership due to the abandonment of many market barriers protecting China's domestic market. The government is very concerned about potential labour unrest as a result of growing unemployment and inequalities and is therefore keen to increase employment opportunities for laid-off workers. A large protest was held in Liaoyang last year, 30 000 unemployed workers opposed the governmental regime, which gave indications of the growing dissatisfaction among the population. In order to prevent similar activities, the government's planned social security system will try to improve the conditions for unemployed workers who are unable to find alternative employment and prevent them to not fall into poverty. The government believes that the workforce in the larger cities will increase with 24 million during 2003 and that approximately 10 million of these people will have a job.¹⁴⁴ On average the personal income tax is 20 percent and it is progressive. The companies pay most of the insurance. Pension plans exist but it is mainly the people in the cities that can enjoy them.¹⁴⁵

4.2.3.3 Infrastructure

Infrastructure development is of utmost importance to promote further economic growth. Today most of the transportation is conducted on the rivers but both roads and railways are being built. Highways are being built to connect important inner regions with the coastal cities for shipments, i.e. Nimbo, Shanghai, and Hong Kong. Further west in China the transportation runs very slowly as the road conditions are very poor and the traffic is quite intense, therefore the trucks must take one container rather than two. The logistic cost is often the highest in China compared to the production cost. The infrastructure in the most developed regions, for example the city of Shanghai, is well developed to handle the intensive transportation and communication within the city.¹⁴⁶

¹⁴³ Swedish Trade Council (2003)

¹⁴⁴ Swedish Trade Council (2002)

¹⁴⁵ Zhang, Charles, Manager Commodities & Trade Finance and Sales, Australia and New Zealand Banking Group Limited, Shanghai

¹⁴⁶ Wernborg, Jens, General Manager – South China, Swedish Trade Council, Guangzhou

4.2.3.4 Country specific industry features

Governmental Influence in Industry

Before the opening up of the Chinese market all export and production were conducted through 12 state-owned trading organisations. These organisations specialised in certain product categories and their existence still shadows the Chinese market. Today, export and trading in foreign currency is still not allowed for all domestic firms. In 2001, 35 000 Chinese companies had an export license which is a quite small number compared to the size of the Chinese market (compare figure with 18900 operating textile companies). This can create difficulties for new traders in the market, as with little knowledge of the market structure, it can be confusing whether negotiations are taking place with a trading house or the producer.¹⁴⁷ Even if the numbers have decreased rapidly, trading houses still exists in China and the market is very complex in its nature. A good example is the Canton Fair, China's largest commodity fair, where all stands are initially given to SOEs, thereafter they can resell their spots to private firms, hence creating an unfair distribution. Furthermore, the representation in the stands are sometimes the producers themselves, sometimes trading houses representing several producers and sometimes a whole city or region who has gathered the best products from their native producers.¹⁴⁸

China has agreed to liberalise its export policies in a three year period starting in 2003 as an effect of the WTO agreement, but exceptions will still remain after 2006 in the following product groups; rubber (natural), wood and some wood products, plywood, wool, acryl and some steel products. Furthermore, foreign companies are only permitted to export their own goods out of China.¹⁴⁹

Trade Restrictive Measures

A subvention is defined as a state economical contribution in term of tax reduction, income support, price support etc., which gives the receiver of the subvention certain benefits against competitors. Some claim that the "bread is cheaper than the flour"¹⁵⁰ in China as the government is providing subsidies to domestic firms which causes heated feelings worldwide. China has agreed to eliminate all forbidden subventions including both direct export subventions as

¹⁴⁷ Chow, Samson, Shanghai Konglong Textile Ornaments Co.,Ltd., Shanghai

¹⁴⁸ Liang, Eugene, General Manager Canton Fair Import & Export Co. Ltd, Guangzhou

¹⁴⁹ Videll, Annika (2003)

¹⁵⁰ Kullbergs, Viktors, Chairman of National Economy Council, Ministry of Economics in the Republic of Latvia

well as local content subsidies, which are subsidies to companies using local material in their production process. China has also agreed to announce all existing subventions to the WTO.¹⁵¹ It is a complex issue to consider when discussing subventions as the government easily can hide them and other regional benefits. As Mr. Liang, Manager of the Canton Fair stated, “a reduction in energy prices in Chinese region effectively reduces production cost, hence enhancing the profit margins of the firms within the region.” This cannot be called a direct subvention but is affecting the competitive situation on the market. This issue is also in close relation with the existence of Special Economic Zones, discussed in the previous section. China, on the other hand, states that these actions are used to stimulate regional development in less developed regions, which is permitted.¹⁵² Effects of continuous use of subventions will be more anti-dumping and anti-subvention taxes imposed by EU, US etc on Chinese goods.

Patents

It is commonly known that China is known for counterfeit products. As a member of the WTO China has to follow the rules of TRIPS, which handle the issues of copyright, branding, country of origin, patent etc., and the Chinese legal system in these concerns has undergone a major transition during recent years. Even if extensive improvements have been made, the presence of counterfeit products is apparent. Some Swedish companies have reported that their products have been imitated both to domestic use in China and to export. In some cases the consequences are so severe that the Swedish companies are using supervising organisations to ensure no counterfeits in the production process. Piracy and copyright problems are stated to be a major obstacle for foreign investments in China. These concerns are most apparent in industries like pharmaceuticals but also very prominent in design and fashion where the design and pattern of the products are the core of the merchandise.¹⁵³

4.2.4 Future Development of China

As shown in the presentation above, China is today enjoying a rapidly growing economy aided by a strict government adhering to the majority of the power within the nations. This enables the stable environment today, but also poses concerns for future developments. In the methodological chapter (chapter 2.5)

¹⁵¹ Videll, Annika (2003)

¹⁵² Liang, Eugene, General Manager Canton Fair Import & Export Co. Ltd, Guangzhou

¹⁵³ Videll, Annika (2003)

the importance of scenario planning and analysis was highlighted, as companies must be prepared for future opportunities and threats. Even if sourcing activities do not engage in monetary investments within the nations, it is still of highest importance to engage in forecast thinking in order to have a sustainable sourcing strategy, as well as alternative plans. China is as described a market with huge potentials, low cost products with competitive quality, though one must try to picture the market one step ahead in the development. Firstly, China will undergo several changes in the coming years where the outcome is of great uncertainty and secondly, as the Chinese economy keeps growing the cost of production will follow the path. Hence, the suppliers will charge higher prices for their goods and consequently reducing the attractiveness. In order to handle these aspects the authors have developed three scenarios presented below which has the objective to establish an awareness of the future development. The rational and method behind the formation of the scenarios is explained in the methodological chapter. There are several different factors to take into consideration when analysing the forthcoming of China's development. In the three scenarios below, the discussions will be structured around five major factors; governmental activities, economic growth, exchange rate policies, industry developments and country specific attributes in order to create three scenarios in symmetry.

4.2.4.1 Worst Case Scenario

The Communist party will stay in power, and, as a response to the subdued growth figures social unrest will arise due to large income inequalities in the rural areas. The differences between the living standard and income level of urban and rural population, as well as the rich and poor will furthermore increase. This will create an unsustainable environment, as the least developed regions will not enjoy any of the economic prosperity that the east coast is enjoying. This will lead to protest and an unstable social situation in China, hence, not giving good indications to future investors. The pressure from the US and Europe on China to abolish the communism regime and to present public election makes the political situation unstable. The introduction of multi-party elections will cause further distress to the government as well as to the social order, as the government is putting too much focus on winning the election rather than improving the overall living conditions.

The GDP growth will slow down and it appears that the government has stimulated much of the previous growth by infrastructure investments and

support of SOEs. The average growth rates will be around 3-4 percent. The leveraged real estate market bubble will burst and cause further disruption to the already distressed banking system. This will become a large financial burden to the Chinese government and further export and FDI promotions are a must in order to cover the costs.

The government will loosen control of the Chinese currency; it will fall for the international pressure to reevaluate, as the dollar will keep depreciating. The government will let the RMB float which will cause currency speculations and mass conversion into US dollar and Euro putting pressure on the RMB. Furthermore, it will impact their producers as the exporting conditions are worsened due to the unstable exchange rate conditions prevailing and extensive price fluctuation. Factor costs such as wage levels will remain low, and especially in the western regions as they will continue to lack behind in the development. China will continue to dominate the world export of manufacturing goods, though with higher level of risk attached, hence small and inexperienced buyers might be reluctant to invest within.

The low-cost labour of China will be exploited and labour intensive production will remain China's main segment. The eastern parts of China are slowly becoming more developed and as a result labour intensive production will move further westwards in the country. Due to the burdened economy the government will have difficulties in financing their infrastructure investments, hence railway and road constructions will not be undertaken as planned, which will leave the western regions behind in the economic development. Certain quotas will apply to the Chinese market after 2005 and in addition, anti-dumping and subventions will furthermore be installed by the US as well as EU as protectionist measures. This will lead to overproduction, especially by SOEs, consequently lowered prices and less profit. China's own production remains for domestic use only and their purchasing power decreases. The country will rely on FDI for further growth.

SARS has a second breakout, though the system is taking precautionary measures the epidemic is not controllable and causes severe effects to the industries as well as casualties. Pollution becomes an emergent problem costing lots of money. Many analysts expect that the membership to the WTO will aid the government to amend more liberal politics, but no improvements are visible.

4.2.4.2 Best Case Scenario

The government of China enhances their relation with EU and US and will be introducing democratic structures successfully, but slowly. The government will keep the trust of the Chinese people due of its success of increasing living standards. Strict policies will be taken against the environmental concerns; encouraging to large level of FDI inflow in this area. Membership to WTO enables the government to pass new regulation to further liberalise the business environment as well as human and legal rights within the nation.

The economy will keep growing without any major disturbances. The worries regarding non-performing loans, real estate bubble and social unrest will turn out to be mere speculations. China enjoys a growth rate of around 8-9 percent in the GDP.

The currency will remain pegged to the dollar in the next coming years which will further stimulate trade as the dollar keep falling a few more percentages and then be stabilised, the RMB indirectly decreases in value which further stimulates growth. Although, China will receive lots of pressure to reevaluate the currency and the government give indications that it will start take measure to prepare for the currency to float and become freely convertible. As China is experiencing continuous rapid growth the factor costs and wage levels will consequently increase. It will remain very competitive in the far west but the transition westwards is going faster than expected. A positive sign will be that the income inequalities will no longer increase at the high rate previously experienced, rather it will stay balances and a middle class with a greater purchasing power will develop.

Developments and investments will further move out to the countryside as well as the labour intensive production. The large governmental investments within these regions pay off and the strategically situated SEZ attracts well-needed resources and know-how. China starts to export their own products and they will start to take up the competition with Taiwan, South Korea etc. China will move upwards on the industrialisation cycle and emphasise trade with higher value-added, though much income is still derived from labour intensive manufacturing as China is so vast and still has many undeveloped regions.

SARS will not have a second round in China, it turned out that is was mere speculations. As China now is a member of the WTO strict actions will be

taken against piracy, legal rights and corruption in order to show the world that it will become a world leader in many areas, not only low-cost production. It also officially states that it will start its progress to becoming a socialised democracy.

4.2.4.3 Most Likely Scenario

The Communists party will stay in control of China in the foreseeable future, though they must compromise in order to remain the power and slow liberalisation procedure will be undertaken. The pressure from the outside world to implement democratic structure is increasing and provides incitements for the Chinese government to introduce public election in the future. The Chinese government will adapt several policies in accordance with the WTO agreement. The government also aims to further improve the situation for the people living in the rural areas in order to avoid social unrest.

The GDP will continue to grow at good rates, around 6-7 percent. Slowly the economy as well as politics is liberalising, which will be positively received by the outside world and further investments within China can be expected. The real estate boom experiences some set back but no overall collapse. The newer stricter regulations regarding investments in real estate on the margin will have effect and the losses incurred can be covered by FDI and tax collections.

The Central Bank of China will be forced to modify the peg against the dollar as the dollar will further devalue a few percentages and then stabilise, hence RMB 8.28 for US\$1 will not accurately reflect the value of the RMB. China will keep the managed float in the foreseeable future and with the intention to in the long run let the currency float. The higher value of the RMB will somewhat affect the price levels, though not enough to cause any disturbance to the exporting pattern. China will remain the status as the world factory, the prices measured in SEK and €value will increase but only marginally. Furthermore, as China increases the value of RMB compared to the dollar, the Governmental money reserves kept in US T-bills and T-bonds will directly increase in value, hence the government will have a larger net worth. The factor costs will increase along with the wage level as a result of the economic prosperity, the labour intensive production will slowly move westwards and infrastructure will be built to support this production shift. Income inequalities will prevail, and increase, but a middle class will slowly develop in the urban areas.

Almost all quotas will be abolished and only large trading partners such as EU and the US will practise a few anti-dumping and subventions measures. As a consequence, little overproduction is created, as most goods are not absorbed by the domestic markets they will be able to go for export. Hence, this will also exclude the likelihood of further deflation. China succeeds with its own R&D and is slowly moving from pure copying production to designing production. Labour intensive production is moved out to the rural areas which are starting to enjoy some economic prosperity, hence the social unrest is somewhat stabilised. Many resources are allocated to improve the infrastructure to the western and northern part of the nation. Much improvement must still be realised though. As the purchasing powers increase, import of western products will increase, which further may liberalise the trade policy between China and EU.

China's membership to the WTO brings along several positive indications in form of market liberalisation and started debate regarding political issues. Though, the steps forward are slow, but also enhance the likelihood of a smooth transition into a somewhat democratic society.

To conclude the scenario analysis of China it is important to remember that this is the authors' subjective view of the development of China. As is highlighted in the scenarios many probable outcomes can be derived, and no certainties can be stated regarding which outcome is the most likely to actually happen, nor in what sequence the developments will occur. What with certainty can be stated is the turbulent future awaiting China, positive or negative, nevertheless changes within the environment will occur. In response, when screening markets choices must include markets of different characteristics, therefore the next chapter will focus on the Latvian market and the potential within.

4.3 Latvia

The previous chapter presented the political, economical and industrial developments of China and it is rather understandable that China possesses enormous potentials for future of sourcing activities. However, there are certain delimitations of China's capabilities in a Swedish perspective, for example uncertainties of tariffs and quotas, geographical distance and complexity of internal business structure. It is therefore of interest to research low-cost markets closer to the Swedish home market in order to establish whether opportunities prevail for sourcing closer to Sweden. As stated before the market-oriented case study of Eastern Europe will be focused on Latvia, to be able to provide an understanding of its potential for sourcing activities in relation to China. The chapter will be structured in the same way as the presentation of China, but it is not a comparison rather a complementary study of the two markets. The attention to the Latvian textile industry will be further emphasised in this chapter as it has not been thoroughly presented in the chapter, explaining the global textile industry.

4.3.1 Political Situation

Throughout history, Latvia has enjoyed little sovereignty as it has suffered from occupations by more dominant nations such as Sweden, Germany and ending with the Soviet Union. In 1990 the collapse of the Soviet Union took place, and consequently on May 4th 1990 the Supreme Court in Latvia declared its renewal of its independence. After bloody assaults by Soviet forces in January 1991 in both Latvia and Lithuania a general referendum was held in Latvia and the result was a support of independence from the USSR. After a coup in Moscow in August 1991 the parliament in Latvia voted on re-establishing de facto independence, restoring Latvia's status as a sovereign independent nation in September 1991. Since its independence Latvia has been a parliamentary republic and most important political institution is the unicameral Parliament called "Saeima". However, since independence, the political situation in Latvia has been characterised by numerous tumults. Disputes between parties in the coalition have led to several collapses of the governments before term ends.¹⁵⁴

¹⁵⁴ Zoubir, Yahia H. & Lhabitant Francois-Serge (2003)

4.3.1.1 The Government of Latvia

The current President of Latvia, elected in 1999, Vaira Vike-Freiberga is the first female President in Eastern Europe. The ruling government is lead by Prime Minister Einars Repse who was elected and installed in October 2002. Prime Minister Repse campaigned with an anti-corruption agenda, which derived from Latvia's past problems with dishonesty within politics and economics. However, striving for a majority government, the election was a disappointment as he only received 26,4 percent and had to establish a coalition together with three other parties. Latvia has had little experience of traditional politics as it has been occupied by other nations for large periods, which can provide an explanation why Latvian politician are more integrated in the business society rather than adhering to political ideologies, compared to for example Swedish politics. Politicians often adhere on single key questions and hot issues that the parties are running, like the anti corruption issues that the current Prime Minister is pro-actively engaged in.¹⁵⁵

The Deputy Minister Ainars Sleers is a hard-core businessman with a history of studies and business in Norway. His view is that Latvia will develop as the European Hong Kong; a financial centre for the whole Eastern Europe, which can be considered rather extreme. The Prime Minister and the Deputy Prime minister are very much contrast to each other. Sleers vision of a future Hong Kong is sometimes opposing the anti corruption issues that is pointed out from Einars Repse. This conflict almost led to a governmental crisis in late September this year. It is however important to note the support for the Prime Minister from the population is big and the Latvian people are exhausted of the corrupt situations that have infected their society.¹⁵⁶

4.3.1.2 Current Governmental Concerns

The most important issue for the government to consider today is the accession to the European Union. The EU membership will result in both opportunities and threats in Latvia's business environment. The largest opportunities derive from the access to the Single Internal Market that will increase the market size of EU from 2,3 million to 500 million. Furthermore, Latvia will from 2005 fall underneath the three pillars of EU, which will further enhance the stability of its political and legal arena. The accession itself in 2005 will not have a comprehensive effect on the national political situation of Latvia as most of the

¹⁵⁵ Karlsson, Gunilla, Counsellor, Swedish Embassy of Riga, Latvia.

¹⁵⁶ *ibid.*

changes within the political framework have already been implemented. The process of political adjustment to EU standards was initiated in June 1993 based on the “Copenhagen Criteria.”¹⁵⁷ The threat of the accession will be whether Latvia will be able to make its voice heard within the European Union and that structural policies will be implemented that are not in accordance with Latvia’s economic situation.

In addition the creation of Euro-clusters within the EU, i.e. intra regions with similar customer needs, demographics or economics, will further strive to strengthen the Baltic Sea region, including Latvia in a worldwide perspective.¹⁵⁸ Many initiatives are today taken by the Scandinavian countries to integrate the co-operation between the Baltic States that in the future can be an important trade area as well as economic co-operation. The meeting arranged by the “Baltic Development Forum” is a good example of this where top-level politicians, business executives, academia and press gather to discuss the future of the region and how to improve the present conditions.¹⁵⁹

Another current issue of importance for Latvia to deal with is the ethnic differences within the country. For example, in Riga the Latvians are a minority and approximately 50 percent are of Russian origin. This could both be an advantage and an obstacle for Latvia, an advantage when it comes to the knowledge and good relation with the Russian market and a threat because of the work to handle the cultural differences.¹⁶⁰

4.3.1.3 Legal Aspects

As in the case of China, the basis for the problems existing within the legal framework in Latvia is mainly derived from the implementation and exercise of regulation, and not the practical formulation of laws. An effect of this is the high number of commercial disputes that is more commonly settled in institutions like the Latvian Chamber of Commerce or the Riga International Arbitration instead of the Latvian Court¹⁶¹

¹⁵⁷ Kok Wim (2003)

¹⁵⁸ Mercado et al. (2001)

¹⁵⁹ Baltic Development Forum Summit Riga, Latvia (2003)

¹⁶⁰ Kullbergs, Viktors, Chairman of National Economy Council, Ministry of Economics in the Republic of Latvia

¹⁶¹ Zoubir Yahia H. & Lhabitant Francois-Serge (2003)

The legal framework in Latvia has undergone major changes since the independence. The judiciary is independent but there are problems concerning the skills of lawyers and the juridical system is often blamed to be subject for bribes, hence corrupted.¹⁶² The Commercial Law of Latvia came into force in the beginning of 2002 and covers incorporation and management issues for companies operating in Latvia.¹⁶³

In addition, the Latvian legislation has to be further developed to fit EU standards and to make it transparent to conduct business in Latvia. As stated by Stig Friberg, Swedish Trade Council, it is often said “whomever pay the most will win the case”. However, Latvia has fulfilled the criteria for EU within the legal framework and has developed laws to regulate the business environment. The future question is whether there regulations are applied and set in function the way they are attended. This will probably be a time consuming process that will change the whole business culture of Latvia and the people’s views of thinking.¹⁶⁴

4.3.1.4 Corruption and Bureaucracy

In a historic perspective Latvia has often been criticised for the existence of corruption especially within the political arena. Also the custom service, traffic police and dispute settlements mechanism has been particularly vulnerable.¹⁶⁵ Today, as stated by Mr. Friberg most of the business in Latvia is sacred from corruption but the most exposed area is industries within public tenders, for example construction projects, where some deals have a tendency to be closed with companies in close connection to the government. According to the CDI report companies stated that public tender contracts are still awarded to personnel networks made up by friends and acquaintances. “They will frequently – but by no means exclusively – consist of a countries own companies”¹⁶⁶.

There have been numerous actions to fight corruption in Latvia, beginning with the “Corruption Prevention Program” (CPI) in 1998. Today one of the most prioritised areas for the government is prevention of corruption, which is both actively supported but in some cases also disrespected by Latvia business and

¹⁶² Zoubir Yahia H. & Lhabitant Francois-Serge (2003)

¹⁶³ Latvian Development Agency (2003)

¹⁶⁴ Friberg, Stig, Trade Commissioner, Swedish Trade Council in Latvia

¹⁶⁵ Zoubir Yahia H. & Lhabitant Francois-Serge (2003)

¹⁶⁶ Confederation of Danish Industries (2003)

in the political arena. However, it should be noted that almost none of the organisations interviewed in the CPI report considered corruption to be a hinder to business any longer.

The existence of bureaucracy is largely evident in Latvia. Within the business sector excessive administrative procedures in document handling are required and signatures often have to be combined with a stamp to be valid. According to Mr. Christer Åkesson, Country Manager Latvia of RIMI he has signed several “deals” with hotels car rentals etc. only to be an administrative ritual for the Latvian companies.¹⁶⁷ Otherwise the administrative procedures of conducting business are developing to be more uncomplicated and adjusted to EU regulation. One of the areas that still have to be further developed in this context is the complex and complicated custom clearance, further explained in chapter 4.3.3, describing the Latvian industry.

4.3.2 Economic Aspects

Latvia is an economy under transition and therefore it holds many of the characteristics thereof. It regained its independence only 12 years ago, still much has been achieved in this short time frame and much is still needed to be done in order to further improve the financial and business environment. Latvia has in the last five years enjoyed a GDP-growth among the highest in Europe, 5,8 percent annually, and as Latvia voted “yes” in its referendum of EU accession, economists and investors are looking very bright of the future of Latvia. It managed to parallel the economic regression experienced by many Euro countries aided by large domestic demand and enhanced trade with other EU-accession countries.¹⁶⁸ Being a part of EU, it will be viewed as a more stable environment and Latvia as a nation can experience more favourable interest rates, receive know-how and predictable legislation. Additionally, more stringent monetary policies will be imposed on Latvia and these may not always be co-ordinated with the economic situation within the country.¹⁶⁹ The largest cloud on the Latvian sky is today the large trade deficit, totalling to 7,8 percent of GDP. Today the account deficit is covered by the large inflow of foreign capital either through direct investment (60 percent) or other financial transactions such as commercial loans, credit borrowing or deposits but it is not

¹⁶⁷ Åkerberg, Christer, Country Manager Latvia, ICA Baltic AB

¹⁶⁸ Ministry of Economics Republic of Latvia (2003)

¹⁶⁹ Kocins, Viestur, Head of European Union Department, Latvian Chamber of Commerce and Industry

sustainable on the run-run.¹⁷⁰ Latvia has throughout the last months continuously been updating its forecasts regarding the GDP growth with the latest figure amounting to 7 percent, up by 0,5 percent, due to high domestic demands, consumption and large level of investments.¹⁷¹

4.3.2.1 Governmental Strategies

The government has recently passed a series of documents which taken together will form the future economic development, all inclusive they form the “Long-term Economic Strategy of Latvia.” Its overall goal is to reach the average GDP per capita enjoyed among the EU countries within 20-30 years. This will be achieved by altering the present economic situation depending largely on the low-cost labour and production of low value added activities. According to the government this may be reached by reviving traditional economic sectors and update it with modern technology as well as developing new post-industrial knowledge-intensive sectors. Much attention in Latvia is directed to the Structural funds, which are believed to bring high level of resources to the country and enable large and necessary investments in the industry and infrastructure. In total the government expects to receive around €200 million and they have already initiated National Development Programs for which money should be given. A large challenge for the government is to enhance the living standard for the urban population where today very primitive conditions prevail.¹⁷²

4.3.2.2 Macro Economy

The overall GDP growth in Latvia has been impressive throughout the last years considering the developments in emerging and developed markets. Between 1996 and 2002 GDP has increased on average 5.8 percent annually, which is approximately twice as fast as the EU countries and 1.5 times higher than the EU-accession countries. Still, Latvia has the lowest GDP per capita of the 10 accession countries if adjusted to purchasing power. Last years GDP increased with 6.8 percent, which was a slight reduction from the 2001 figure of 7.1 percent, still good considering the external environment. The largest contributions to the GDP growth are trade, manufacturing, commercial services and construction. The forecast for 2003 is expected around 7 percent and most indications states that the next coming years will provide growth rates around 6

¹⁷⁰ Zunda, Vita, Office Manager, IMF Riga

¹⁷¹ Swedish Trade Council - Marknadsplats Östersjön

¹⁷² Ministry of Economics Republic of Latvia (2003)

percent. With the GDP growing at high rates it is vital to highlight the underground economy, which still is quite large in Latvia, estimates claim that it amounts to around 25 percent of the GDP.¹⁷³ Latvia has had a growing GDP, though as previously mentioned they have the lowest GDP per capita taken into consideration purchasing power parity within the enlarged EU. Latvia's PPP adjusted GDP per capita is 8983 US dollar and this is also very unevenly distributed among the country.¹⁷⁴ As of today, Latvia has a purchasing standard of 35 percent of EU average; looking exclusively at Riga this is equivalent to 50 percent. Improvements in the macro-economic environment have a social bearing. The segregation in income distribution is increasing; poverty is becoming more widespread as well as unemployment, which shows large divergence in different regions.¹⁷⁵ Polarization of material well being of people is increasing. The gini-index has gone up from 0.3 in 1996 to 0.34 in 2002, equivalent to US standards.

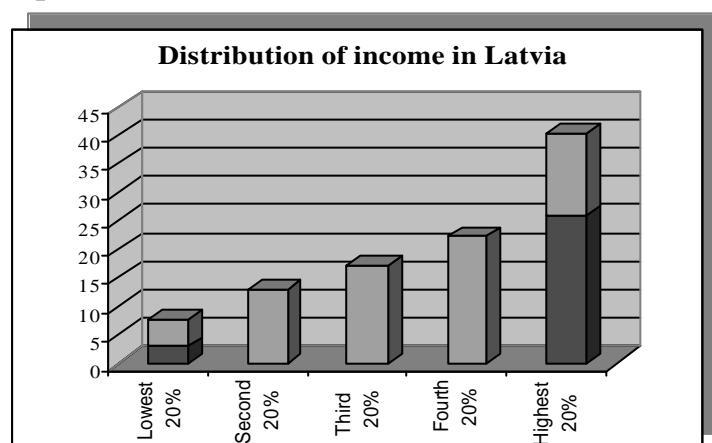


Figure 19; Latvia Income Distribution 1998

Source; World Development Indicators, World Bank

As seen in the chart above, the distribution of income is skewed to the right side with top 10 percentile (marked in dark grey) accounting for 25 percent of income and consumption and top 20 percent accounts for 40 percent of income and consumption. Still, a positive indicator is that the overall household consumption has increased by 71,3 percent in Latvia between 1996-2002, and slowly a middle class is gaining grounds in Latvia.¹⁷⁶

With wage levels steadily increasing, 44 percent between 1997 and 2002, as well as consumer spending, the government has still been able to keep inflation

¹⁷³ Zunda Vita, Office Manager, IMF Riga

¹⁷⁴ World Bank Homepage (4)

¹⁷⁵ Ministry of Economics Republic of Latvia (2003)

¹⁷⁶ World Bank Homepage (5)

under control. Latvia's inflation is among the lowest taking transitional countries into account, it has in the last 5 year period averaged around 2-3 percent annually and is expected to continue with similar figures in the next coming year. This is graphically shown in figure 20 below.

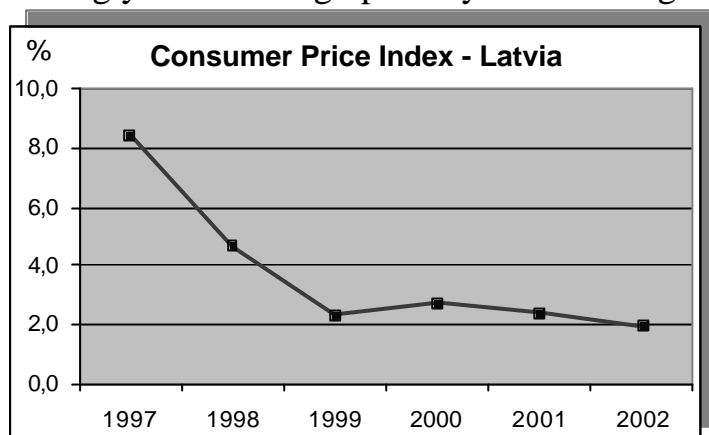


Figure 20; Consumer Price Index 97-02

Source; World Economic Outlook, IMF 2003

During, and recent after the Russian crises, Latvia incurred major price fluctuations as seen in the graph in year 1997, but these are nowadays under control. The government is currently working with adjusting relative prices to the world prices as a preventive action for the EU accession. The annual consumer price inflation in 2002 was 1,9 percent.¹⁷⁷

4.3.2.3 Exchange Rate risk

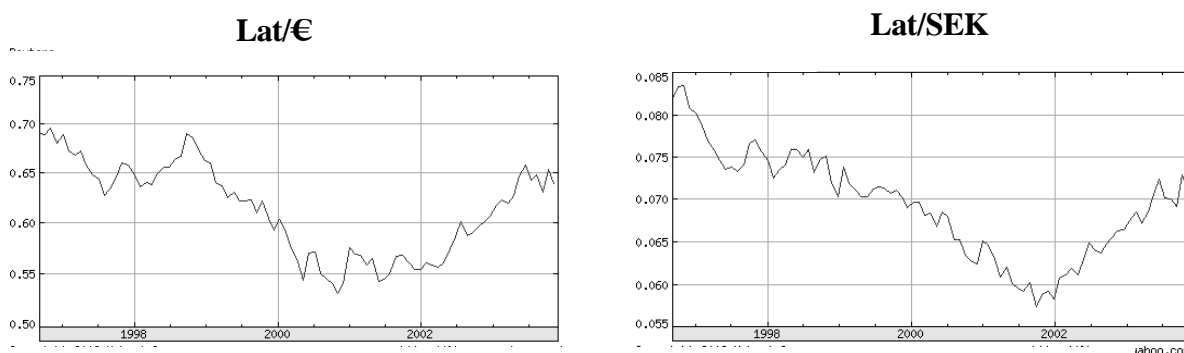
Even though the rapid economic growth experienced in Latvia, it has experienced a relatively stable macro economic environment with stable exchange rate and low interest and inflation rates. The Lat is pegged to the SDR, IMF currency basket, and it has remained stable since inception which is an important basis for businesses since it reduces risk and currency exposures and facilitates price planning.¹⁷⁸ The decision of the Bank of Latvia to peg the Lat to SDR was based on the fact that two of the five currencies of the basket, US dollar and Deutsche Mark, were widely used by Latvian entrepreneurs in domestic and external trade.¹⁷⁹ The SDR basket composition is reviewed every five years to ensure that it reflects the relative importance of currencies in the world's trading and financial systems. The latest update was made in January 1st 2001, and the present SDR basket hold a value of; 45% US dollar, 29% Euro,

¹⁷⁷ Ministry of Economics Republic of Latvia (2003)

¹⁷⁸ *ibid.*

¹⁷⁹ *ibid.*

15% Japanese Yen and 11% Pound Sterling.¹⁸⁰ Hence, it is quite dollar denominated which affects Latvia in an exporting position within the European Union as the dollar recently has fallen.



**Figure 21; Exchange Rate Fluctuations Lat/€ and Lat/SEK,
Source; Yahoo Finance <http://finance.yahoo.com>**

By looking at the two graphs above, one can see the impact of the stronger dollar during late 2001 and the beginning of 2002 as the Lat were strengthened against both the SEK and the Euro. Throughout this period speculations fluctuated as to whether the Lat was overvalued, hence pegged to the SDR at a too high rate as well as too much dollar influenced which would negatively impact export. Though, Bank of Latvia declined with the explanation that export could not enjoy growth, as in the case of Latvia, with an overvalued currency. There is price discrepancies visible in the society where cost of goods to not match level of income.¹⁸¹ Today, with a decreasing dollar value against the Euro, a different scenario might present itself to Latvia where it can start to enjoy a more favourable exchange rate position with will enhance its trade. What can be discussed is whether Latvia, with its present trade pattern of EU dominance, ought to have its currency pegged to a basket which is largely influenced by the US dollar and indirectly the US's economy.

The duties by Bank of Latvia will turn into a new phase when the Lat will leave the peg to the SDR. Upon accession, the Lat will join the strict band of ERM2 as a first step to full membership to the EMU. In order to prevent major fluctuation in the exchange rate the Latvian central bank has already started a stepwise process towards ERM2. Currently they are actively engaged in a campaign for the local currency. In the end of October this year an IMF

¹⁸⁰ International Monetary Fund (IMF) Homepage

¹⁸¹ Market Access and Compliance Homepage

delegation from Washington will visit the Latvian Central Bank and provide guidance in the transition. Latvia expects to join the EMU in 2008.¹⁸²

4.3.3 Industry Development

Latvia has a history of soviet interests in the industry sector. During the soviet era Latvia served the military-industrial complex and specialised in production of electronics, radio and communication resources, chemical and pharmaceutical products, heavy machinery and foodstuff. When Latvia gained its independence almost all Russian controlled industries closed down and a few tried to convert and adapt to the new market conditions with the resources left. Many industries suffered during this period and several inefficient former communist companies went bankrupt. In the last few years, many of these industries have been revitalised, in addition Latvia has large natural resources in its forestry, which much trade is derived from. Still the traits from the Soviet era are present in the society as they are struggling with the entrepreneurial spirit, marketing, and customer adaptation. Latvia is slowly moving upwards in its manufacturing trade. Previously, due to differences in consumer taste and preferences much of the trade has been directed to other Eastern European and CIS countries, today this has been redirected to EU.

Within the industry sector an immense part of the foreign investment is within technical production. A Swedish example is the IKEA Group, which has invested in sawing mills and manufacturing of glued laminated furniture components. Other investments within sales and marketing are made by Kesko (ICA's Finnish competitor), which has conducted Greenfield investment within the retailing chain for food products.¹⁸³ Today industry accounts for 20,2 percent of the GDP. There are four main industrial centres or clusters in Latvia consisting of, Riga, Daugavpils, Liepaja and Jelgava. From a manufacturing perspective, Daugavpils with its extensive plastic production and Liepaja with its textile cluster is of importance.¹⁸⁴

As Latvia is trying to update its industries, innovations represent a cornerstone to stimulate fast economic growth and the Research and Technology Development (RTD) department is supposed to provide the basis for this transformation. The Latvian RTD is besides the government also supported

¹⁸² Zunda Vita, Office Manager, IMF Riga,

¹⁸³ Latvian Development Agency (2003)

¹⁸⁴ Zoubir Yahia H. & Lhabitant Francois-Serge (2003)

from EU resources such as PHARE and the Structural Funds as well as other regional sources e.g. Baltic-Nordic countries cooperation.¹⁸⁵

A lot of attention is given to the high-tech and biotech industry as the coming industries and from which Latvia will build its future growth. Although, today it is important to experience growth in the existing industries to provide a basis for income. Latvia has a long history in wood processing, textile, agriculture and machinery and it is important to modernise these industries and make them competitive. The key success factor for the future is to find a niche in present industry segments where Latvia can gain competitive advantage and sell value-added products as well as continue the stated aim of becoming a leader in certain bio or high-tech sectors.¹⁸⁶ According to an analyst at Baltic International Centre for Economic Policy Studies (BICEPS), it is believed that Latvia's forthcoming industry will be much dependent on FDI investments in a certain industry rather than governmental strategies. However, governmental policies improving the business environment are important to encourage these kinds of investments.¹⁸⁷ One organisation working to promote this is the Foreign Investors Council in Latvia (FICIL), as they are representing the voice of international companies operating in Latvia, in dialogues with the government on how to improve the business environment.

As mentioned before the FDI inflow in Latvia has been steadily increasing since the independence. The main source of direct investments in Latvia has been and still is from neighbouring countries. Investments from Sweden, Germany and Denmark makes up almost 40 percent of the total FDI stock in Latvia and consist of investment in finance, telecommunication and export oriented manufacturing.¹⁸⁸

4.3.3.1 The Textile Industry in Latvia

The textile industry is one of the most important industries in Latvia today. At the end of 2000 the textile industry employed roughly 20370 people which equals 16,6 percent of all industrial employees. The growth of the industry has been steady and between 1996 and 2000 the output within the industry has risen 1,2 times. The division of growth differs where for example spinning of textile fibres has increased 3,6 times. The value of total export of textiles and

¹⁸⁵ Ministry of Education and Science in Latvia (2003)

¹⁸⁶ Kocins Viestur, Head of European Union Department, Latvian Chamber of Commerce and Industry

¹⁸⁷ Alashejeva, Julia, Baltic International Center for Economic Policy Studies (BICEPS), Latvia

textile articles in 2000 was worth approximately 262 million US dollar. The amount of export of textiles to the European Union has increased dramatically from 41 percent in 1994 to 77,7 percent in 2000. Also when comparing the export of textiles with the total export of Latvia the number has increased from 13,2 percent in 1994 to 14 percent in 2000, which shows that the industry is still competitive.¹⁸⁹ It is important to consider the fact that Latvia is price takers on the global market. It should also be stated that the prices of textiles on the world market are stable.¹⁹⁰

The strength of textile industry in Latvia is the combination of low labour cost and relatively high production. Also, the human resources play an important role in the textile industry when there is a good access of high skilled engineering staff, further discussed in later chapter. This is also in connection with the historical aspects of Latvian textiles where Latvia, during the soviet times, where one of the main producers of textiles to the soviet army. This lead to an accumulation of knowledge in the industry which is still visible in the country.

There are both domestic producers and foreign producers of textiles in Latvia. A Swedish example is the sewing firm Snickers which produces work wear etc. Examples of the biggest domestically firms are Lauma, Rimako, V.O.V.A., Viola-Stils and Ogre. These producers have invested large amounts of money in modern production equipment to be able to stay competitive in the global market. Most companies that design finished goods internationally have developed computerised design workshops.¹⁹¹

The weaknesses of the Latvian textile industry today are the marketing. Because of the historical background of Latvia and the era of central planning the marketing was non-existent. Since 1990 this issues have had to be developed from the beginning and it has taken a long time. The bigger companies has started to attend international fares, but if looking at promotion expenses as a percentage of the net sales it is yet far to go before marketing

¹⁸⁸ Latvian Development Agency (2003)

¹⁸⁹ Latvia Development Agency Association of textile and clothing industry (2002)

¹⁹⁰ *ibid.*

¹⁹¹ *ibid.*

could be considered to be a central part of the budget within a Latvian company.¹⁹²

4.3.3.2 Human Resources

The human capital in Latvia is a key economic asset and there is access to a relatively high skilled labour at low costs. Latvia is today considered a low-cost producer, but as it is striving to increase its overall economic position, they must move towards a value-added production and a skilled labour force is a must for success. The availability of specialists into the labour market is high and Latvia is rated second highest per capita ratio of students in Europe, after Finland. The natural science and technology, particularly IT and applied technologies are increasing in importance, most likely an effect of the outspoken policies by the government to focus on high-tech and bio-tech industries.¹⁹³

The unemployment rate is quite high in Latvia, 12.1 percent. The trend has been downward sloping but unevenly distributed among the regions as well as demographic settings. The share of young and uneducated unemployed is dominant and 46 percent of the unemployed are on a long-term basis. One obstacle to overcome is the low mobility of the workforce, this cause trouble to regions, which experience unemployment figures at 16-17 percent. In addition, the hidden un-employment rate is higher than the given figures and often the unemployed are of long-term characteristics and affecting the young.¹⁹⁴ The labour cost in Latvia is among the lowest of the 10 Candidate Countries even if gross average monthly wage has been increasing significant as seen in the chart below. In 2002 the average monthly wage amounted to 280 US dollar (LVL173), which is an increase of 74 percent from 1996.

The wage earned in the primary workplace is often not enough to support a family; therefore, many workers have an extra job. In addition, many workers still receive an official pay cheque along with an envelope with cash. There are substantial differences between the private and the public sector, average public wages are 24 percent higher, which is partly attributed from the inadequate accounting records in private enterprises as well as the additional envelopes.

¹⁹² Latvia Development Agency Association of textile and clothing industry (2002)

¹⁹³ Latvian Development Agency (2003)

¹⁹⁴ Zoubir Yahia H. & Lhabitant Francois -Serge (2003)

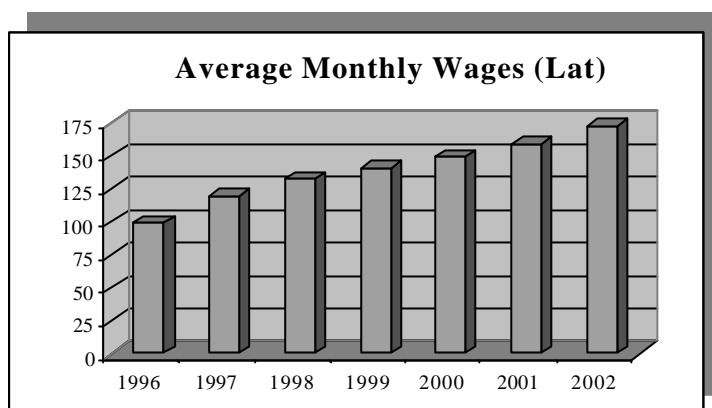


Figure 22; Average Monthly Wages in Latvia
Source; Economic Development of Latvia Report

Developments have occurred in the pension payments, however, which are still far below living conditions, and in 2002 pensions averaged LVL 62,14 per month. A critical factor for the Latvian economy is the negative growth rate and net migration that has been persistent for the last years. Ministry of Welfare has developed an action plan to improve the negative demographic situation.¹⁹⁵

4.3.3.3 Infrastructure

The infrastructure in Latvia is in need of updates as it is built on lasting pieces from the Soviet regime. Further developments rely on efficient infrastructure, a first step to join Scandinavia and the Baltic States is a highway currently being built that will connect Helsinki with the Baltic nations. Latvia is dependent on its harbours, as most goods get shipped by sea and the Ventspils harbour is the largest ice-free harbour within the region. Negotiations are being undertaken between Latvia and EU regarding the Single Programming Document and which projects that could be eligible for support as of 1 January 2004. More than EUR 1.1 billion will be available from the EU budget for the promotion of Latvia's infrastructure investment, the productive sector, competitiveness and measures for generating growth and creating jobs.¹⁹⁶

4.3.3.4 Country Specific Industry Features

Latvia's Membership to the EU

The enhancement of the Single Internal Market with several low-cost producers will play an important role of stimulating intra regional trade. This can potentially affect the external trade policies, especially towards developing

¹⁹⁵ Ministry of Economics Republic of Latvia (2003)

¹⁹⁶ European Union Homepage

countries. There are no doubts that an enhanced EU's intra-regional trade will increase even further when tariffs and boarder controls will be eliminated, favouring low-cost markets like Latvia. According to a report by the Confederation of Danish Industries (DI) in 2000, one of the most important issues of Latvia and the other Baltic States was the administration in connection with custom clearance. Most importantly the determination of dutiable value, lack of clarity in connection with positioning of customs classification and difficulties in obtaining export permits and licenses. According to a follow-up to this report made by DI in June 2003, all Baltic States have made great progress in the past years as regards to these aspects. The legislative problems described in the report from 2000 was according to the interviewed companies no longer a significant problem and this is further put forward by the Commissions progress Report 2003.¹⁹⁷ This is an important aspect to consider, because several companies still believe that it is to risky and complicated to enter the Latvian market and do not consider the immense progress that has been made in that area.

Energy Supply

One main threat within the industrial sector in Latvia is the potential of increasing energy prices. Latvia is poorly endowed with fossil fuels and is therefore a net importer of energy, which makes the industries very vulnerable to changes in energy costs. Since its independence Latvia has liberalised and privatised the energy market and oil market, but the electricity market is still controlled by the Latvian State. Latvia imports most of the oil from Russia but is investigating the potentials of oil offshore in the Baltic Sea.¹⁹⁸ The energy supply is an obvious cost driver as well as obstacle in the production process. Many companies structure much of their production after the hours of the day when the energy costs are lower, i.e. they start later in the morning and go longer at night.¹⁹⁹

SMEs

One of the main governmental concerns of today is to enhance the Latvian entrepreneurship and stimulate growth of Small and Medium sized Enterprises (SMEs). It is believed that the Latvia government pays to much attention to FDI and the multinational companies operating in Latvia. According to the

¹⁹⁷ Confederation of Danish Industries (2003)

¹⁹⁸ Zoubir, Yahia H. & Lhabitant Francois-Serge (2003)

¹⁹⁹ Kacija, Rita, Marketing Manager, Mezroze

Latvian Traders Association (LTA), which is a private owned organisation working to promote and support domestic Small and Medium sized Enterprises in Latvia, the traders are not a priority in Latvia. Previously, the government provided the SMEs with support for computers and IT access but today all of these supports are taken away even if only approximately 50 percent of the SME members in the LTA have access to Internet.²⁰⁰ However Viestur Kocins, Head of European Union Department at the Latvian Chamber of Commerce denies that the government focuses more on attracting FDI rather than stimulate local production. The government's funds are limited and therefore spending is limited on local as well as international firms, but as new legislation is being implemented in accordance with the EU policies the business climate for foreign investors certainly improves.²⁰¹ The low level of SME start-ups pose a future worry as EU is largely composed by SME and believe that most economic prosperity is derived from the sector. Latvia today has 17 SME per 1000 habitants, which can be compared with 26 in Estonia, and 52 in EU average.²⁰²

4.3.4 Future Development of Latvia

Latvia has throughout its independence experienced both ups and downs, and in recent years it has shown remarkably economic growth after the Russian crisis. The political arena has showed some instability and large changes are likely to occur as they enter the EU. The economic and political future will be dependent on how successful the reforms taken will be as well as external influences as Latvia is a small country highly dependent on its surrounding environment. Hence, there are several different factors to take into consideration when analysing the forthcoming of the Latvian development. Depending on how Latvia further develops its position as a potential sourcing market for ICA Non-Food might drastically be altered. In order to highlight the potential forecast of Latvia, three scenarios will be presented below. The discussions will be structured around similar factors as in China; governmental activities, economic growth, exchange rate policies, industry developments and EU accession in order to create three scenarios in symmetry.

²⁰⁰ Danusevics, Henriks, Chairman, Latvian Traders Association

²⁰¹ Kocins, Viestur, Head of European Union Department Latvian Chamber of Commerce and Industry

²⁰² Kullbergs, Viktors, Chairman of National Economy Council, Ministry of Economics in the Republic of Latvia

4.3.4.1 Worst Case Scenario

The turbulent situation within the sitting government leads to a collapse of the coalition as no agreement can be achieved on questions of importance. This will further reduce the peoples faith in politician and without Mr. Repse as Prime Minister the corruption will remain an obstacle to trade and experiences slow development after EU accession. Corruption will disrupt trade as well as the use and division of EU Structural Funds by distributing resources to wrongful projects. The consequence is an unfair competitive market where some industries will have a hard time to survive.

GDP growth will slow down and average approximately 3-4 percent GDP annually. As previous years of very high growth of GDP has provided a higher base GDP, this will make it difficult for Latvia to provide continuous similar high growth numbers. Furthermore, the unstable political situation disables further investments within the country.

Latvia will change its currency from being fixed within the SDR currency basket to join ERM2 as the first step to EMU accession. Initially, the currency will be subject to severe pressures and speculations, which will derive in large currency fluctuations and difficulties to stay within the narrow span of ERM2. The relation between the Dollar and the Euro will remain uneven with a strong Euro in relation to the considerable weak dollar. As the Lat previously was highly dollar influenced, they are forced into a new situation where a strong Euro is the trademark. This will pose difficulties for Latvia as their export goods will be perceived as more expensive due to an unfavourable exchange rate when trading with non-euro nations such as Sweden.

The factor cost will remain low with a slower increase of wage levels than expected. Most government investments will be directed to high-tech and biotech sectors, which become failures, therefore Latvia will depend on the existing labour intensive industries as a source of income. The prominent industries will continue to be traditional and labour intensive industries in the secondary sector. Wood, food and textiles are still the most important industries and production is mainly located in the urban areas. Infrastructure will be poorly developed, and due to lack thereof, it will be impossible to develop and establish industries in the inner parts of Latvia.

EU will not give any certain incentives for protection of the production and industries within the Single Internal Market, which puts Latvia in a situation with direct competition with low-cost producers like China. Furthermore, as Latvia is already fighting with slower growth rate the domestic industry will compete both against Asian and Western produced goods, hence Latvia will be trapped between the differentiation and low cost provider. It is possible that as a result of the above mentioned that an increasing trade and relation are being rebuilt with Russia and the CIS as an alternative market. The Latvian voice in the EU context is in relation to its size very weak, which will make it difficult to raise and get response on questions concerning Latvia.

4.3.4.2 Best Case Scenario

The present government will remain until the next election. The policies implemented as well as economic strategies are proved to be successful. The government's focus on corruption will pay off which will consequently lead to further investments as many foreigners are more inclined to invest within the nation with the increased transparency. The EU Structural Funds are evenly distributed to project and organisation in most need of the funding. Latvia will enjoy a similar effect of the Structural funds as Ireland has. And as Ireland has used its location advantage to Europe, Latvia will successfully use its closeness to Russia and the CIS.

The economical development will not quite reach the forecast made by some people within the government, i.e. two-digit growth, though it will average around 7-8 percent annually. Several large foreign investments in Latvia in connection to sound economic policies will make this possible.

The Euro will be stabilised against the dollar, which facilitates trade for Latvia to non-euro countries, i.e. Sweden, while it consequently takes away the trade advantages to countries trading in dollars. The process of pegging the Lat to ERM2 will be a smooth process and the currency even though floating is keeping within the stricter bank of ERM2. The fact that the Lat will completely abolish its dollar connection will not lead to any complications in its trade pattern rather an improvement as it now follows the European economic growth pattern.

The increase in GDP growth will be reflected in the wage levels that steadily increase and are closing up levels enjoyed in low-income parts of Greece,

Spain and Portugal. Along with increasing wages, productivity and level of value added which will also follow path enabling Latvian industry to remain competitive. The developments and economic prosperity experienced in Riga will move out to rural cities such as Daugapils and Liepaja and a more evenly income distribution will be achieved. The industries will develop quickly and Latvia is moving towards a focus on the tertiary industry with a focus on service industry. Riga will become a centre for banking and insurance and several international companies operating in all three Baltic markets has established in Riga as the centre for its Baltic affairs. Different clusters of IT, Biotech etc. will be developed derived from FDI and organic growth. Labour intensive production like textile will reduce in importance, and rather be outsourced to other nations like Ukraine, Belarus etc. with lowed wage levels. The infrastructure will be further developed and efficient and well functioning connections will exist to all urban areas as well as surrounding countries.

The EU membership has lead to numerous advantages for Latvia and EU is also giving incentives to protection of the industries in the Single Internal Market. This makes it easier for Latvia to stay competitive as a trading market in comparison with other non-EU countries like Russia.

4.3.4.3 Most Likely Scenario

The governmental focus on reducing corruption will be fairly successful but remain an issue and needing further improvements. EU puts a lot of pressure on Latvia to reduce the level of corruption, which will make it important for Latvia to make improvements in this area in order to improve the general presumptions of Latvia. The EU Structural Funds will constitute good support to the Latvian Industry and the administrative procedures and organisation of the money is working. Many projects will turn out successfully, and it will improve the living conditions in the rural areas.

The economical development of Latvia will enjoy increasing levels of 5-7 percent of annual GDP growth. The government will strive to enjoy stable and sustainable developments. The exchange rate, Euro-dollar parity is stabilised will improve Latvia's comparative advantage when trading with non-euro nations.

The Lat will join the strict band of ERM2 upon accession into the EU and it will incur minor price fluctuations causing some disturbance to the overall

price levels as well as trade balance. The government will have to work hard in order to ensure the foreign speculators that the Lat is a stable currency functioning in a managed float such as the ERM2. In regards to trade with countries such as Sweden, the Lat will appreciate to a certain extent as they have previously been partly influence by the depreciating US dollar. In the long run, the abandonment of the SDR for ERM2 will show to be the right move, as the Lat from now on will reflect the European growth and economic condition rather than the United State's.

The labour costs of Latvia will increase but remain low compared to EU-average and as productivity is following path and price levels are slowly increasing Latvia will keep the inflation in control. Domestic differences in the wage levels will prevail, and the most visible increases derive from companies situated in Riga. An increased focus on service industries and value-added activities can be expected in Riga as a result of the increasing the wage-level. Traditional industries like, wood, food and textile will constitute the majority of the GDP composition as well as remaining the most important exporting products. These industries will undergo transition in order to enhance their competitiveness. However, the labour intensive production has moved to rural areas. The R&D and design development will further embrace the European as well as Scandinavian taste, as these will constitute the most important exporting markets. The ability to market the domestic firms and make them visible in the Single market will become a key for success, and many Latvian firms will successfully perform this. Infrastructure will remain under construction but much effort will be directed to improve the domestic transportation and communication system. It will become easier to travel to and communicate with urban areas of Latvia. Infrastructure will no longer be considered to be the most important obstacle when locating industries or engaging in trade with companies in the rural areas. Also airports and shipping ports have been developed to serve the international markets.

The membership to the EU will include possibilities for Latvia to enjoy a larger market size for sourcing and selling. It will be easier to conduct trade within the European Union and the risk of external tariffs etc. will vanish. It will encourage the entrepreneurial sprit within the nation as well as the start up of SMEs. Furthermore, the Latvian market will be perceived as more stable and secure as it is nowadays is governed by EU regulations. There are also signs

that EU has incentives to encourage the industries within the EU in relation to other low-cost producers like China.

To conclude the scenario analysis Latvia, similar to China, faces a future with many uncertainties. Latvia will through its membership with the EU increase its stability and predictability. A combined picture of the scenarios conducted on China and Latvia is presented in Appendix II, which also highlight the importance of sourcing actions in relation to each separate combination of scenarios. As a part of Latvia's geographical proximity to Sweden, there exists an enhanced understanding for the difficulties put forth in Latvia as well as a desire to support the economic and political transition. Hence, there prevail different interests in Latvia and China from a Swedish perspective.

4.4 Swedish Interest in China and Latvia

China and Latvia have in their trade relation with Sweden two contrasting situations, which can be stated by the charts seen below. The import to Sweden from Latvia is about the same size as the goods being shipped out from Hong Kong (marked in dark grey) to Sweden. Though, it must be remembered why the focus is on these two countries. It is because the authors want to analyse their relative potential in a present and future sourcing perspective. As Latvia has a population equivalent to 1/6 of Shanghai's it is quite clear that their potential derives from different sources. This makes none of them of less interest, though focus might be on other different products and purposes.

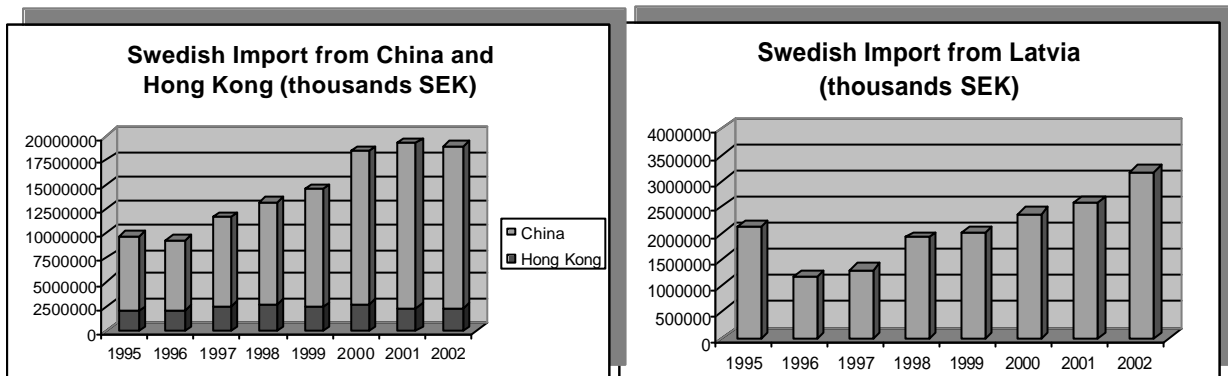


Figure 23; Swedish Imports from China & HK
Source; Statistics Sweden www.scb.se

Figure 24; Swedish Imports from Latvia
Source: Statistics Sweden www.scb.se

Throughout recent years imports from China has rapidly expanding, interesting though is that little result was noticed after the WTO membership in 2001. Import figures presented in first half of 2003 states that China is the 13th largest importer to Sweden and its share of export accounts for 2 percent of Sweden's total import.²⁰³ Shanghai has today taken over much of the activities previously handled by Hong Kong trading houses as Shanghai today is considered by many to be the economic frontier of China.²⁰⁴ Traditionally, Latvia has been one of the larger trading partners of the accession-10 countries, although in recent it has incurred a slower export growth than some of its neighbouring countries. Still, its relative export to Sweden is increasing, but the quantities are not even comparable to the Chinese. Many Swedish firms' success today largely depends on their cost competitive import from China, which has enabled them to offer large quantities to low prices to the mass market.

²⁰³ Swedish Statistical Bureau Homepage Database

This can be stated as the graph (Figure 24) on previous page shows over a 200 percent increase in import from China over an 8-year period. Veckans Affärer, a Swedish business magazine, recently published an article with the title “Low prices – thanks to the dictatorship,” where they state that if Chinese politics were to be questioned in an open debate many firms’ net profits might be in danger. This is a drastic statement, though it nevertheless highlights a provoking question. H&M for example purchase 1/3 of their total assortment from China, which is worth around 20 billion SEK, and they have around 200 employees working in 4 different offices responsible for about tens of thousands textile workers. Similarly, China is the most important sourcing market for IKEA.²⁰⁵

204 Jiang, Caroline, Industry Dept. project Manager, Shanghai Foreign Investment Development Board, Shanghai

205 Hähnel, Fredrik, General Manager – East China & Nilsson Sofie Information Manager, & Swedish Trade Council, Shanghai

5 SUPPLIER SELECTION ANALYSIS

Chapter 4 presented the empirical findings concerning the retailing industry in a global, domestic and ICA perspective followed by a presentation of the two researched markets of China and Latvia. In this chapter all perspectives of our research will be connected in a supplier selection analysis presented below that will provide the structure to be able to answer the questions presented in the problem formulation.

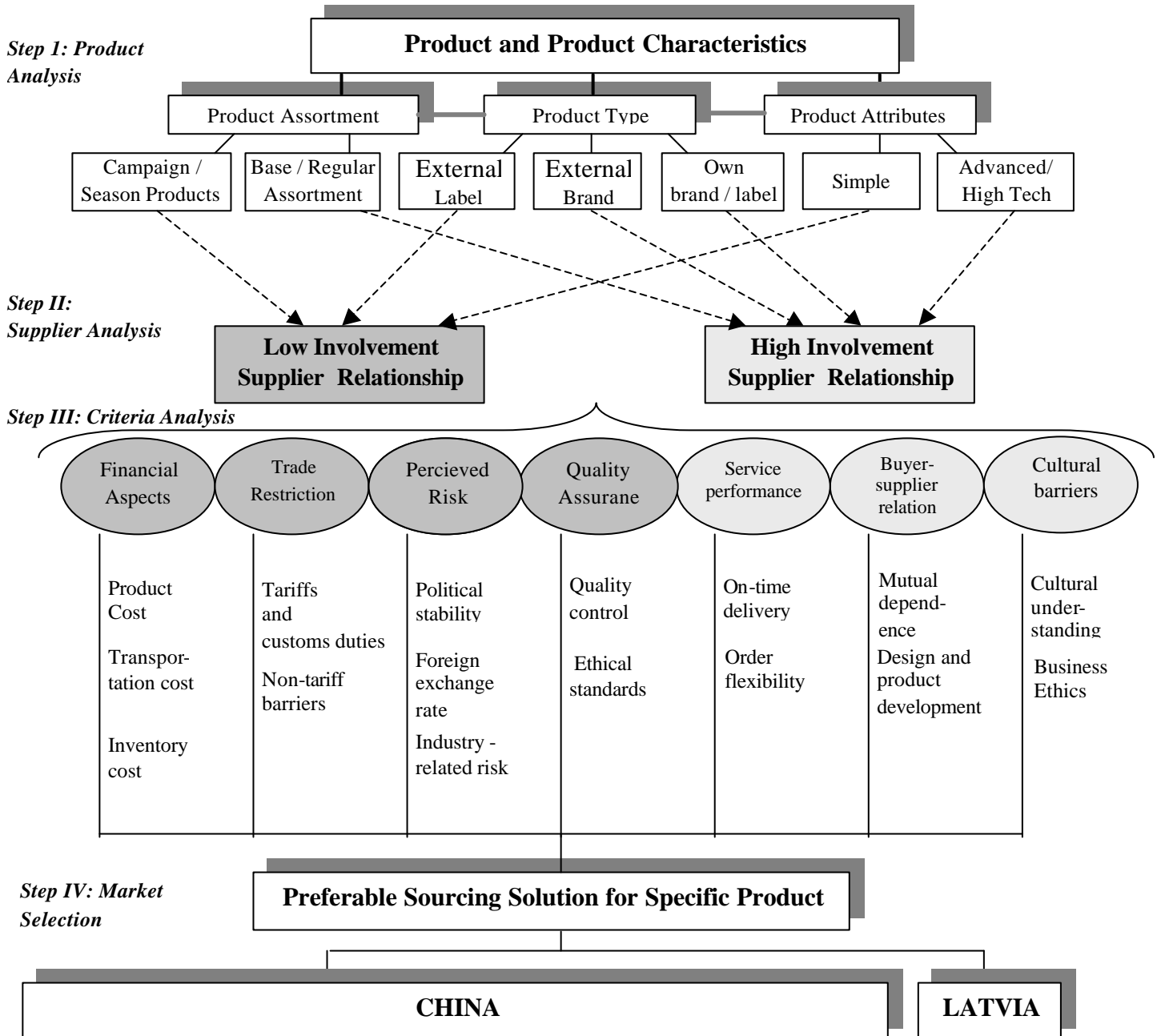


Figure 25; Modified Model of Supplier Selection Process

The analysis will be based on the Modified Supplier Selection Model, thoroughly presented in chapter 3.4, where the original supplier selection model was connected to a product and supplier relationship perspective. As stated in the theoretical chapter the aim of the modified model is to provide an encompassing guide in the supplier selection process. The model analyses different markets and their present and future sourcing potential. The initial ambition, to divide the purchasing process and the market screening process in a time sequence, proved to be unattainable. This is due to the purchasers' own experience and network, which highly influences their market screening sequence, it proved impossible to put forth a general framework for the process. Furthermore, a quantitative survey was undertaken where the authors, aided by the Product Manager of Home Textiles, tried to identify the level of importance of each aspect. However, as the reality of purchasing is dynamic, and decisions are taken in different context, this proved impossible to conduct in this study. Therefore the model is applied as an analytical tool to be able to draw qualitative rather than quantitative conclusions on market potentials.

The model, rather than look at the sourcing process in a time sequence, distinguishes the most important steps in the supplier and market selection process namely; product analysis, supplier relation analysis and criteria analysis. In this way the model is applicable to the majority of products within the retailing sector and could be utilised by most companies within the retailing industry. The rational behind the model implies that the purchaser has established two or more potential market that will be investigated more thoroughly in the model.

In order to apply the model in the case study, the analysis will be linked to the Home Textile department of ICA Non-Food. The forthcoming analysis will present both the model and the rational behind each step of the supplier selection process. Two similar products within the home textile segment, bed sets and sheets, will be tested in the model to firstly describe the functions of the model, and secondly assess how ICA Non-Food department can structure its sourcing activities within these two product groups. The analysis will in chapter 5.1 and 5.2 focus on internal factors and the changes occurring within. The later part, 5.3 will focus on the external factors, i.e. market and supplier condition, and analyse how these co-ordinates with the internal factors.

5.1 Product Analysis

To be able to conduct an analysis of where to perform sourcing activities it is of utmost importance to be familiar with the product of interest and the significance of its characteristics. The product analysis is divided into three different aspects; Product Assortment, Product Type and Product Attributes.

5.1.1 Product Assortment

The analyses of product assortment focus on the function of the product, whether it is a part of regular assortment or a campaign or seasonal product. The main difference between these two is the continuity and regularity of orders where the regular assortment products are frequently ordered and the product characteristics are not changing over time. In this case a high involvement relationship with the supplier is preferable in order to secure regular supply and to establish a stable quality of the products. The switching cost in this case is rather high because of the importance of identical product characteristics in the regular assortment. The campaign or seasonal products refer to an order of large quantities to supply a campaign and will be in the store for a limited time. In this case one large order is made rather than a reoccurring process, which consequently reduces the importance of a deeper supplier relationship; hence best practise can be used in each order, which also reduces the switching cost.

In the case of home textiles an example of a product within the regular assortment are the sheets, which are stable products, purchased regularly and in small orders. The product characteristics are constant, with only minor changes in colours and designs occasionally occurring, which indicates the importance of establishing a longer relationship with the supplier to secure regularity of the product, hence high switching cost. Bed sets are an example of a product within the seasonal assortment and therefore different conditions are prevailing. The product itself is a regular product, though the designs, models and colourings are continuously changing therefore the need of regularity in the ordering process diminishes. In most cases it is only one large order supplying a campaign or a season design on the bed set. In this case the relation with the supplier takes a transactional rather than relational mode and enables ICA Non-Food to change suppliers between the purchases as a consequence of lower switching costs.

5.1.2 Product Type

The second aspect of the product analysis concerns the Product Type, which is divided into three categories; External Labels, External Brands, and Own brands and labels. External labels refer to clothing, kitchenware, food products etc. with no specific brand connected to the product. In this case a relationship with the supplier is not of great importance, as the consumer demand for the product is not connected to the brand but rather to the product itself. An external brand like Nike or Felix is often purchased in large quantities, as consumer demands for these specific brands are usually high. It is therefore important to create a relationship with the suppliers as the external brands are often integral to the store's long-term success and win-win situations in the supplier relationship ought to be created. In regards to an external label the question of high involvement relationship is not as immense as in the first category. The third category refers to own brands and labels developed by the retailer itself, which as stated before, are increasing within the retailing industry. If the product belongs to private labels the product is in itself connected with the company name brand, in this case ICA, and therefore a high involvement with the supplier is important to be able to secure all part of the product value chain and final quality.

In the case of ICA Non-Food and the products, sheets and bed sets, both are a part of the ICA private labels. They are falling under the Deco Design concept, which is the trademark ICA Non-Food uses for its home textile products. In both these cases the demand of a high involvement with the supplier is required to be able to secure quality of both the product and the supplier as the products are connected to the ICA brand.

5.1.3 Product Attributes

The third aspect concerns the product attributes and refers to the technological complexity of the products and production process. It is hard to state general categorisation of advanced and simple products within the retailing industry, it must be conducted in context of the specific company and its product offerings. As indicated by the name, simple product refers to standardised products with a simple production process. The advanced product category includes aspects of technological complexity, high R&D costs or technological risks connected to the product, for example electrical products. In this case it is important to create a high involvement relationship with the supplier to be able to secure the

quality of the product and reduce the risk of product default as it can have severe consequences.

The sheets and bed sets offered by the Home Textile department of ICA Non-Food are considered to be simple products, even if the development of bed sets includes aspects of design. In this case the product attributes of the two products do not imply a high involvement with the supplier.

To conclude the product analysis it is clear that it does not exist a definite answer to the question if a low or high involvement relationship is preferable. Nevertheless, the analysis can provide an indication of most appropriate relationship mode, for example, if two out of three categories imply a high involvement this ought to be considered thoroughly before choosing a transactional mode. However, it has to be stated that the aspect of high involvement is considered stronger than the low involvement aspects and as soon as one aspect indicates a high involvement relationship this must be considered before deciding on a transaction mode. Even in the case of ICA Non-Food home textiles and the cases of sheets and bed sets this dilemma is apparent. The sheets are categorised to be a part of the regular assortment, it is a private label and a simple product, which implies that two out of three arrows indicate a high involvement with the sheet supplier. In the case of bed sets it is a part of the seasonal assortment, it is a private label and a simple product, consequently two of three aspects indicates that low involvement is preferable with the supplier. It is clear that that the reality is not as black and white as the model states but it provides general guidelines to understand the interconnectiveness between the product characteristics and the supplier relationship.

5.2 Supplier Relationship Analysis

The product analysis provided a good understanding of the product attributes, which in a second stage, identifies the requirements of the supplier. As stated before the reality is not black and white as the model implies, and the level of involvement with the supplier can vary in many different aspects. However, it is important to distinguish if a high or low involvement is preferred.

The model does not distinguish low involvement attributes from high involvement, instead high involvement adds three more criteria that are

important to take into consideration. The model points to seven attributes, whereas all are of great importance in sourcing activities, but three can be further emphasised in a high involvement relation, though none of the criteria necessarily exclude the other. The focal aspects to analyse in a market perspective, regardless of level of involvement, are Financial Aspects, Trade Restrictions, Perceived Risk and Quality Assurance. They are directly connected to financial cost and the possibility of conducting trade based on risk, trade regulations and quality control. The last three categories; Service Performance, Buyer-Supplier relation and Cultural barriers refer to aspects of special importance for high involvement relationship with the supplier. The relative importance between these aspects is not illustrated in the model as it varies between different products and product groups.

In the case of sheets and bed sets the first analysis indicated a preference for a higher involvement relationship with the sheet supplier. The underlying rationale was the high switching cost connected to the change of supplier. In the case of bed sets the analysis pointed to a preference for lower involvement because of the independence of respective order which indicates a lower switching cost. The purchase is also made one by one in bigger quantities. By having said this, it is interesting to further analyse the market, in this case China and Latvia more thoroughly to investigate how well they apply to these regards in both a market and supplier perspective.

5.3 Criteria Analysis

The next step of the supplier selection model is to conduct a criteria analysis. This aspect of the model focuses on the market driven factors in order to determine whether favourable conditions prevail on the specific markets for sourcing activities. This part of the analysis will focus on the Chinese and Latvian markets in order to establish their competitive edge within sourcing in general, and more specific on the case of Home Textiles. The criteria analysis is divided into seven different aspects followed by subheadings in each criterion. The significance of each criterion varies depending on researched product group. In the case of home textile, which is more thoroughly investigated in this report, existence of quotas is of highest importance and a prerequisite for trade whereas in another product group it is not even relevant.

The disposition of the criteria analysis is to initially present the criteria and why it is important in a retailing perspective, followed by a deeper discussion of respective aspect included in the criteria. This is followed by a presentation and discussion of the relative importance of each aspect in the perspective of Home Textiles.

5.3.1 *Financial Aspects*

In any purchasing activity, financial aspects are of utmost importance, and there are direct as well as indirect costs related to the purchase. It is important when looking at costs to not stare blind at the product cost itself, rather to look at all cost drivers within the sourcing process as this model is aiming to do. In the financial analysis emphasis will be on product costs, transportation cost and inventory cost as the most important cost determinants. The two researched markets are offering products at a generally lower cost compared with Scandinavian or Western European standards, though the two nations differ in cost structure as well as geographical distance from Sweden which makes certain products more suitable in one market than the other.

5.3.1.1 Product Costs

The product cost is most certainly incremental in the decision making process, and it is often subjected to intensive negotiations before final price is set. However, the important aspect is that the best price does not always need to be the lowest; rather it is the most competitive price, taking all aspects into consideration, that determines the deal. China is, in most cases, an outstanding low cost producer in the world today and is about to become the world factory. Compared to other nations with similar competitive advantages, China will also in the future be able to remain a low cost producer because of its huge labour pool and potential of skewing production westwards. Latvia is still a low-cost producer, though not in the same league as China, neither should Latvia be compared with China as they offer sourcing solutions based on different wants and needs. Latvia will seldom offer the lowest price, but it will offer the most competitive price on certain products requiring a different sourcing mode. However it should not be forgotten that in a Swedish perspective the Latvian product costs are much lower than domestic or other present EU-countries' prices.

The importance of cost is of highest importance in the case of home textiles. The variation of importance differs between the different products, as well as

product categories, as some are more price sensitive than others. For example, ICA's private label Deco Design and the products within incur more cost pressure than the external home textile assortment. It should also be remembered that ICA is primarily a food retailer, which is a very price sensitive market and the non-food sector within ICA is also influenced by this. By this said, it is understandable that the relative importance of price in sourcing activities of home textiles is very high, with a consequence of reduced attention to other important aspects.

5.3.1.2 Transportation Costs and Time

Transportation cost is a direct cost adding to the purchase price. As international trade is a daily occurrence, cost and time of shipping has dramatically decreased, though there are always the problem with delays in shipment, and wrongful or defective shipments. The vast geographical distance from Sweden to China, requires a detailed planning in the sourcing process and well as thoroughly planned logistics in order to maximise the efficiency and minimise the cost of the shipment. Large bulk orders must be made in order to fill containers and the transportation from China to Sweden can be estimated to take at least 30 days by sea, depending on what seaport the shipment leaves from. Latvia holds the competitive advantage of geographic proximity to the Swedish market, which increases its attractiveness in both transportation cost and time. Latvia has the potential of becoming an attractive sourcing market for selected products, as the goods can be transported to Sweden in around three days. Furthermore, as Latvia will join the EU, former customs declaration including paperwork and bureaucracy should vanish.

Within the Home Textile department of ICA, transportation cost is not of considerable importance in the case of China and Latvia, where prices does not differ as much as one could believe. As ICA Non-Food purchase large quantities of products from China containers can be filled and it is possible to negotiate good prices with carriers. In the case of Latvia there are not so many deliveries and the price negotiation of the transportation is conducted for each time with reduced possibility for price reductions with carriers. However, the importance of transportation time is even higher as the lead-time from order to received goods varies enormously. In the case of China, the lead-time is around 90 days and this can be compared with Latvia, which has a lead-time of approximately 30 days. The transportation time decreases the flexibility of the sourcing and as the time-to-market aspect increases this is of greater concern.

5.3.1.3 Inventory Costs

Imports from China often require large orders, in order to fill containers and to be able reach economies of scale. As a consequence of this the inventories increases and subsequently the inventory costs. Large inventories create large amounts of tied up capital as well as reduced turnover ratio of firms, and it is therefore important to evaluate the availability of inventory and the cost of keeping the products in warehouses before reselling. Latvia has the advantage to ship smaller quantities, which reduces the pressure on the inventory costs. The geographical closeness and the smaller size of Latvian suppliers enable small purchase orders and make the production more flexible. This is beneficial for smaller sized companies (in a global context), like ICA Non-Food.

The inventory cost is to a certain extent neglected within ICA, probably deriving from the fact that the warehouse is operating separately from ICA Non-Food in Västerås, Sweden. The cost of inventory is included in the overall budget as a standardised cost, which thereby reduces the incentive of altering the purchasing system in order to realise cost reduction and consequently enhanced profit margin by reducing inventory. However, the high level of inventory kept by ICA Non-Food is of importance to re-evaluate, both in regards of space limitations and large amount of tied up capital, and more emphasis ought to be put on reducing the inventory.

5.3.1.4 Concluding Remarks

Latvia and China offer two completely different sourcing solutions in the case of price structure, whereas China can produce low cost products that pressure the logistical costs. Latvia offers products with an initially higher cost but lesser pressure on the logistics and inventory as smaller quantities will be ordered. However, even with all these aspects taken into consideration, China is still on the throne of manufactured goods, though Latvia states as an excellent example of a potential complimentary market due to its geographical closeness. As China will advance in its production more orders will be placed with suppliers within the market, but it is important not to put all ones eggs in one basket, i.e. one must spread the sourcing activities in order to find an optimal solution. As stated before the food-retailing industry is very cost sensitive, which is also the case within non-food and the home textiles. Therefore, the relative importance of price in the analysis increases and in some cases eliminates the influence of other important aspects. However, it is

important to consider how important the price function is allowed to be in relation to the other aspects.

5.3.2 Trade Restrictions

The opening of global trade and the reduction of trade barriers is a theoretical illusion, and the reality shows that besides the reduction of trade barriers other obstacles to free trade are increasing. Political interests and protective actions by nations develop trade issues to be a part of the political game between nations and regions in the world. This is especially visible in the case of textiles where numerous protectionist measures apply. Trade restrictions causes market imperfections as it disables competitive nations to export the goods they efficiently produce, like in this case Asian textile producers who are limited to certain quotas, and have anti-dumping and anti-subvention taxes imposed on their goods.

5.3.2.1 Tariffs and Custom Duties

As a consequence of the phase out of quotas in 2005, EU and US will most likely introduce other market protective actions. Almost certainly, an increase of other tariffs like anti-dumping, anti-subvention and the increased exercise of safeguard measures will be evident. New tariffs will result in extra costs added to product cost by up to 30 percent when it comes to anti-dumping tariffs and approximately 10 percent in anti-subvention tariffs. This reduces predictability of conducting trade outside EU and indicates a risk in the international textile trade, which forces the purchaser to constantly be prepared on changes in trade conditions. China and Latvia have very different standpoints in regards to the applicability of trade restrictions. In May 2004 Latvia will be a part of the Single Internal Market, and consequently not be subject to tariffs when trading within the EU. In addition, the custom declaration procedure will be taken away which will reduce the administrative time and cost in customs and make it easier for import from EU member countries. China will be subject to numerous tariffs and trade restriction as a consequence of protective actions from EU and US that will alter its cost-efficient production. The purchasers have to consider this in relation to the importance of low price, and handle the Chinese market in an efficient manner. China will probably be subjected to several tariffs in regards to export to the EU and US market in order for them to protect their domestic production and trade. Latvia will in this perspective be in a favourable position as EU's intra regional trade within textile accounts to 2/3

of total trade, hence there will be incentives for EU to protect the continuation of this.

The aspect of Tariffs and Custom Duties is as explained before, of great importance to ICA Non-Food, and especially within home textiles. As the textile industry is categorised by simple low cost products surrounded by protectionist measures, purchasers must shop around in order to find an optimal and functioning sourcing base, hence the switching cost is low. As the implementation of tariffs and duties affects the purchasing price it directly impacts various nations competitiveness, hence can eliminate potential sourcing markets. Although, this can work in both ways, for example, the total abolishment of tariffs on imports from Pakistan made it very attractive for purchasing even if the market otherwise possibly should not be considered as the ultimate sourcing market. The existence of tariffs is dynamic and it is important to constantly foresee new potential changes. Therefore, this aspect is considered of highest importance within the Textile Department. It has also been mentioned that there is a huge risk of increased anti-dumping, anti-subvention and safe guard measures to be undertaken after the phase out of quotas, which will have severe affect on the Home Textile department.

5.3.2.2 Non-tariff Barriers

The issue of non-tariff barriers is more complex than the above mentioned anti-dumping and anti-subvention measures. Non-tariff barriers refer to trade restrictive measures that are not directly connected to monetary concerns, for example quotas, country of origin marking of products, ethical directives on producers and environmental directives for imports. The issue of quotas is quite unique and will further be discussed below. The influence non-tariff barriers have on global trade is hard to measure as it is of non-monetary nature. Still it is influencing consumer behaviour and ought to be considered a trade barrier. Most likely an increasing number of these trade barriers will be visible in future perspective as increased attention is given to ethical and environmental concerns.

In the case of quotas, all textile quotas will most likely vanish in a future perspective. Phase out of quotas is set to 2005 and will presumably be achieved, but most likely followed by an increase of other trade restrictive barriers as explained above. Also, this aspect mainly concerns imports from China where aspects of environment, ethical and social standards has achieved

high attention. In the case of Latvia the accession to the European Union will be a great help, as it reduces the risk of these aspects to be applied, because of the EU policy of harmonisation and standardisation of products, in accordance with the “Cassis de Dijon” case.

For those product categories affected by quotas the initial screening process must always begin with establishing whether quotas are available for export both on a national and firm level. In a historical perspective the quotas have sometimes made it impossible to conduct sourcing in affected markets even though competitive products and prices. However, as explained in the thesis the existence of quotas should be abolished, and this will open up new potential as well as increases the predictability of trade. However, other aspects of non-tariff barriers will still be apparent as explained above and this will have the potential of affecting the area of home textiles.

5.3.2.3 Concluding Remarks

International trade is, and will also in the future, be impacted by various tariffs and non-tariff barriers as there are many protectionist measures taken in the global trade of today. It heavily impacts sourcing decisions and the actions usually affect the emerging countries. As stated before it is the characteristics of the product that influence the significance of trade restrictions, and textile products is highly affected compared to other product groups. China will in the future have an uncertain development whereas EU and US most likely will utilise their rights to keep its protective politics against textiles. Latvia will in this case provide a stable environment as it will be included within the Single Market and enjoy free trade within. This is a risk that has to be considered and put in relation with the discussion of the dilemma between cost-focus and risk-reduction. However, in a sourcing perspective the trade barriers are not the single risk to consider but also the overall risk situation within the market.

5.3.3 Perceived Risk

The risk attached to countries is dynamic, as it is continuously changing, and it must also be seen in relation to other nations in order to gain an understanding of the current and future situation. The aim of sourcing is not to be located in risk-free areas, but it must be manageable, and sourcing must include a balanced portfolio where different sourcing markets compliment each other. In this section an analysis of the existence of risk on the markets, in the context of sourcing is conducted. This is in regards to political risk, exchange rate

exposure and industry risk to assess the markets' relative risk potential as well as how this co-ordinates with the wants and needs of ICA's sourcing policy. To give an example, Pakistan is an outstanding textile sourcing market, but it is politically unstable and the Ministry of Foreign Affairs has recently issues a warning to travel within the country. As a consequence, Pakistan cannot be considered an optimal sourcing destination as the purchasing company cannot perform company visits or ensure the quality of production.

5.3.3.1 Political Stability

Both Latvia and China are considered stable political markets, though not compared to the levels enjoyed in the Scandinavian markets. Furthermore, the level of stability has different grounds in the two researched markets. China has similar to Latvia previously been a suppressed nation, and both of them are starting to liberalise its political and economical environment, although, the comparison is between a giant with dwarf. China still practises communism whereas Latvia in their upcoming EU-accession clearly takes a standpoint embracing western ideologies and establishment of democracy. China is stable but authoritarian, and faces the challenges of providing sustainable growth for its population, as well as implementing democratic policies. Latvia is more volatile and has experienced several governmental collapses, but as it soon will fall beneath the EU umbrella its political environment can be expected to improve. In regards to sourcing textile products in the markets, as it is a simple product not needing much investments or R&D, the most important aspect is that the country offers a stable and predictable environment where one can travel freely and conduct business under a working legislative framework. This is upheld in both Latvia and China.

As sourcing activities within the Home Textile departments does not imply an intense relation with the political system in the sourcing market, if compared to other larger investment, this aspect is not considered to be of great importance to ICA Non-Food and the Home Textile department. Naturally, the sourcing market needs to be transparent and predictable as the political stability highly influences the business environment.

5.3.3.2 Foreign Exchange Rate

China has, similar to Latvia, a young currency, both pegged in order to prevent fluctuations that can disrupt the economic transition and both have received pressure to both revalue and devalue the currency, though neglected to fall

for the pressure. None of China's and Latvia's currencies have a future of remaining pegged, and Latvia has already taken its first step, as it will join ERM2 upon EU accession. China, on the other hand, is today enjoying favourable trade conditions as it is closely pegged to the dollar, which has fallen rather dramatically throughout the last year, though creating enhanced currency exposure for importers not favourable in the long run. Textile is a very price sensitive sector as it is a low-cost product with little value-added attributes, thereby fluctuation in dollar-euro parity drastically alter the comparative cost advantages of nations.

Swedish retailers, who trade with a floating SEK are constantly exposed to exchange rate fluctuations, and in the current situation with a low dollar value relative to the euro, it is more favourable to trade with dollar denominated markets, and especially with the RMB, which is mainly pegged to the dollar. Today, the Asian producers trading in dollars have a favourable position compared with the accession countries, though this is not sustainable in the long run. Latvia will join the ERM2 and they will alter their present US dollar influence to completely follow the Euro fluctuation and indirectly the condition of the European economy. This will most likely provide a better situation for Latvia as the Lat has previously traded at quite a high rate due to the high dollar value, hence their export was perceived more expensive. Although as the dollar is depreciating the Lat has also followed the path to a certain extent.

China's currency is today said to be undervalued, and will in the future appreciate against the dollar, and in the long run, float on the open market. This will in the beginning lead to speculative pressure on the currency, though as the Chinese economy will keep growing it will stabilise. Taken together, the exchange rate risk is higher in China as the future is more uncertain, though the position today with the Lat trading at parity or little above, the Chinese goods are perceived cheaper (in a Swedish perspective), and especially as Latvia sell their goods in Euro value.

The aspect of exchange rate is considered important to the Home Textile department of ICA Non-Food as it is conducting most international business transactions in US dollar and Euro. As the products are very price sensitive and exchange rate fluctuations are highly influencing the final price of the product, and consequently exchange rate fluctuations can have a significant effect on purchasing decision. As ICA Non-Food is reducing its currency exposure using

forward contracts in six months increments they balance the price fluctuations deriving from currency fluctuations, still exchange rate fluctuations influence purchasing decisions. To give an example, Latvia was perceived as a potential sourcing market for home textiles, and was highly prospective some month's ago, but as the US Dollar has kept depreciating. The attractiveness of the Latvian market compared with dollar denominated markets has completely altered, which has put Latvia in a very unfavourable situation.

5.3.3.3 Industry Related Risk

Many different aspects within the country's operating environment affect the competitiveness of industries in a worldwide perspective. The most visible are the governmental strategies within the economy as well as increases in factor and wage levels. As both China and Latvia are enjoying rapid growth they are both advancing towards more value added industries, as well as increased living standards, i.e. higher wage levels. Both governments also strive to enhance the high-tech and biotech sector. But a reoccurring issue is the vastness of the Chinese market and the large unexploited areas prevailing. In regards to labour intensive production, China has a competitive advantage over Latvia as China has close to endless labour resources, and as the eastern region of China will advance and factor costs will rise, the production will move westwards. Conversely, Latvia with a population of 2,3 million will only for a limited period of time act as a potential sourcing market. There is a clear risk that the textile industry will be an un-prioritised industry and that it will be followed by a move of the textile industry to other regions like Ukraine and Belarus.

The aspect of industry related risk is highly connected to the political aspects of the markets. In the case of home textile the importance of this aspect is not regarded as high as many of the other aspects, and currently there is no or little concern in the analysis of industry related risks in the sourcing decision. However, as the sourcing strategy takes a more long-term perspective the importance of analysing industry potential is increasing. In addition, it is important to analyse the industry related risk in smaller markets like in the case of Latvia, for the Home Textile department to be able to view the future potential of sourcing. A sudden governmental decision of making textile a non-prioritised industry it will have severe affect of the producers on a smaller market.

5.3.3.4 Concluding Remarks

The two researched markets are by no means risk free, many issues have been highlighted in analysis above, though one must compare cost factor with the risk factor and then make a trade-off. There are two dynamic nations that are being investigated and both of them are striving to enhance their economic development. The products within home textiles are simple products often identified with production in developing nations, hence it is important to investigate the speed of the economical transition and which industries that will be emphasised. Furthermore, political stability and the exchange rate exposure are often related to emerging markets and must be taken into account. China is today considered a stable sourcing destination with manageable risks. Although it is starting to develop more advanced industries and liberalisation policies but no major changes can be expected that would disrupt China's position as a leading sourcing market within Home Textile, the production will only be moved westwards. Latvia will, as it is acceding into the EU and strives to enhance its economic transition, and consequently offer a limited potential as a sourcing market in a long-term perspective. But its present status, and in the coming years, it would be advantageous to utilize the Latvia market. In the future, countries such as Belarus, Ukraine etc, will be the next step. However, the markets ability to provide a risk free environment is not interesting if it cannot provide purchaser to products with good quality in relation to the price.

5.3.4 Quality Assurance

The importance of quality assurance is immense within retailing and quality control of suppliers is a must to conduct. As the development of private brands and labels within retailing increases, the quality control increases in importance as the company brand is connected to the product in itself. In addition, increased attention has been given to environmental and social conditions in the suppliers' factories. In an international perspective these concerns are even more important as cultural differences affect working condition, working standards, wage levels etc. This analysis is divided into two different aspects of quality control and ethical standards.

5.3.4.1 Quality Control

Quality control includes the importance of controlling the suppliers in order to secure the quality of the products within the production process. It is important to understand that this does not imply the quality of the product but rather the quality of the production process. The quality standards, for example ISO

certification, simplify this process but the importance of personal visits still remains, as it must be followed up. In this way the company gains control of the production process, which increases the possibility of having the goods, finished in time. The globalisation of trade has made this process more complicated as companies often trade with several markets. In the case of ICA they are present in numerous markets and the time- and cost-consuming process of conducting company visits is immense. Many companies establish representative offices on different markets to be able to make the quality control easier. As geographical distance influence the possibility of conducting company visits the two markets of Latvia and China posses various potentials. As Latvia is close to the Swedish market the possibility of visiting the suppliers and follow the production process is much higher that the case of suppliers in China.

In the case of the Home Textile department of ICA Non-Food the quality control is very important especially if a high involvement relationship is desired. However, the process of conducting company visits is difficult as the suppliers are situated on many different markets like China, India, Pakistan and Thailand. Today, the Product Managers responsible for the quality control and it can be questioned if this is an optimal solution or if it could be possible to have a representative office on the larger markets like China to be able to reduce the responsibility from the Product Managers

5.3.4.2 Ethical Standards

Ethical standards are closely connected to the quality control, discussed above, but refer to the markets and the suppliers' possibility of fulfilling ethical standards. In Sweden the importance of fulfilling ethical standards is very high as the companies conducting sourcing activities internationally are intensely observed by media and interest organisations. It is easier to control the ethical standards in a market geographically closer to the home market. It is also easier to relate to a more familiar culture, and understand its view on ethical standards. As Latvia is becoming a member of the European Union it will follow EU regulation on these concerns, which will make it more predictable and reliable. China is also taking great steps towards fulfilling ethical standards as it is now a member of the WTO and need to follow WTO regulation. However, it should be stated that it is more important investigate ethical standards in China than in Latvia, even if all suppliers need to be controlled.

As in the case of quotas, further explained when discussing non-tariff barriers, also this aspect is considered to be a key indicator for further discussions regarding sourcing possibilities. If the ethical standards are not fulfilled no excuses can be made in its defence. Home textiles and the textile industry overall, has been surrounded by scandals, hence it is important for ICA Non-Food and the Home Textile department to always consider ethical standards to be of greatest importance.

5.3.4.3 Concluding Remarks

As explained above, the quality assurance is of highest importance in a market screening and a supplier selection analysis. Even if not directly connected to financial terms, the aspects are considered key determinants to if a supplier relationship can be created or not. In some cases it can be hard to economically motivate these aspects in a sourcing analysis but the cost of not adapting to the standards is even higher.

5.3.5 Service Performance

The service performance is of importance whether the purchase is in a transactional mode or a relationship creation, though it is more important if the aim is to develop a high involvement relationship with the supplier. It is often the level of service performance that determines whether a supplier stays or goes. The two highlighted aspects in the model are on-time delivery and order flexibility as measurements of service performance. Furthermore, on-time delivery can be discussed to be of great importance in both high and low level involvement, but it reaches a higher dimension in the in a long-term relationship. To give an example of difficulties in regards to service performance one can look at Indian textile producers, they are highly skilled and produce good quality products at low prices. However the business ethics in India and by Indian suppliers is not that strict in on-time delivery and the risk of late deliveries is rather high, which increases the risk factor.

5.3.5.1 On-time Delivery

On-time delivery is closely connected to the time-to-market concern and both refer to the importance of having the products in the store at the specific date and time decided. Within retailing industry this is of utmost importance because of high customer expectations of a full products assortment. For example, when ordering Christmas products, these items must be available in the store at a specific date in order to be sold, hence the logistics are of great

importance. As ICA Non-Food purchase FOB, they take responsibility of the goods at shipping point from the sourcing market to Sweden and ICA AB has specific logistic departments tracking the goods along the way. Most often it is not the risk connected to the transportation that is important but rather the on-time delivery by the supplier to the seaport. If an order is delivered late to the seaport it can take many days before it can be shipped as a consequence of fully loaded ships.

This aspect is considered of high importance to the Home Textile department of ICA Non-Food as the time-to market is of immense importance. This is also connected to the fact that the Home Textile department orders large amount of seasonal campaign products for Christmas etc., and it is of utmost importance that these orders are delivered on time. Even if this aspect is connected to the high involvement relationship in the model, it is almost of greater significance when dealing with campaign products than regular assortments. In addition, the importance of establishing an order system with the supplier concerning the regular assortment is significant as these products need to be available in the stores at all time.

5.3.5.2 Order Flexibility

By having a sourcing market geographically closer to the home market the buyer can enjoy higher level of flexibility in its inventory and ordering process. Some goods may require this, meanwhile certain goods may be indifferent, as large quantities are ordered to enjoy economies of scale and cost reductions. The order flexibility is not in direct connection to the geographical distance of the sourcing market but as there is no order flexibility during the transportation, the flexibility decreases in relation to increased distance. Another aspect of order flexibility is the customer base of the supplier. Smaller suppliers can better adapt to smaller companies like ICA Non-Food's needs. The size of the supplier is not connected to any specific market and China and Latvia has the same potential of fulfilling the needs. However, China has a larger possibility of mass-scale production whereas Latvia's strength would be to provide the buyer with flexible and adaptive solutions for products and inventory requirements.

Within the Home Textile department the order flexibility is not considered very important as most orders are put in a specific date and there should not be any or only a few changes. However, it is a great benefit that orders can be changed

as a consequence of changed market conditions or altered customer demands as it reduces the risk of creating huge inventories of unsold products. As Latvia's smaller size of markets and suppliers could indicate an increased possibility for order flexibility.

5.3.5.3 Concluding Remarks

The aspects of service performance are more connected to the specific supplier than the market in itself. However, the market structure can differ and as a consequence provide initiatives for increasing service performance. Though, some factors are static such as the geographical distance to China, which reduces the suppliers' flexibility, and to certain extent also their possibility for adaptation. Latvia, on the other hand, poses a great competitive advantage due to favourable geographical position. As Latvia is unable to compete on pure price competition it must focus on value added activities such as on-time delivery and order flexibility. Much of the future of Latvia depends if they can adapt to firms needs. If this can be provided the incitements for creating a higher involvement relationship increases.

5.3.6 Buyer-Supplier Relationship

As new requirements are being imposed on the buyer, it consequently demands responsiveness among the suppliers, and successful suppliers aim to create relationship with their customers in order to ensure future businesses. Today, many discuss the post-modern society and the importance of relationship building to create mutual dependence rather than spot transaction. This model chooses to approach the buyer-supplier relationship from two different standpoints; mutual dependency and design and product development as major incentives to create high involvement relationship.

5.3.6.1 Mutual Dependence

It is important to establish a win-win situation in a purchase agreement in order to make both parties engage in the relationship. In the case of home textiles, though excellent sourcing, the Chinese market offer a big drawback in its size and production quantities as an order from ICA Non-Food might be prioritised as orders are received from huge companies like IKEA and Wal-Mart. Much effort must be spent in order to find a producer whose values are in accordance with ICA Non-Food's, and a supplier that respects and values ICA Non-Food's order quantities. Latvia is a very small market, not used to large quantities, nor could it handle it, and consequently an order from ICA Non-Food would most

likely be treated with due diligence. ICA Non-Food's relative importance in Latvia is not even comparable with its position in China where the difference in size of the two markets is immense. However, it is important to realise that Latvia cannot handle big orders from companies like IKEA because of the small-sized industries. This should not be the problem with the Home Textile department of ICA Non-Food as they do not purchase large quantities.

The aspect of mutual dependence is considered to be more important if a high involvement relationship is developed between the Home Textile department and the supplier. It is important not to be too small a customer to a supplier if a relationship should be established, as larger customers will probably gain more attention and priorities than smaller customers. In this case it is considered better for the Home Textile department to search for suppliers where a mutual dependence exists. On the contrary the case where Home Textile department of ICA Non-Food becomes too big it reduces the possibilities for the supplier to gain further knowledge and ideas by other customers.

5.3.6.2 Design and Product Development

As private labels are becoming increasingly prevalent it is important to take preparative actions for future product and design developments. It is important to analyse and decide if the design and product development will take place within the company, by a middle hand or by the producer. In the case of ICA Non-Food, this is in most cases handled by either own personnel or by agents as in Home Textile departments. In a future perspective it would be of interest if this could be a joint process between the suppliers and ICA Non-Food. Today, neither China nor Latvia has an advanced product development or design. Because of cultural distance it is also difficult and especially hard for the Chinese producers to understand the Scandinavian taste of design. However, it should be stated that even Latvian producers have difficulties in understanding the western and Scandinavian style, but is slowly improving as they are redirecting their trade towards EU.

In the case of the Home Textile department within ICA Non-Food, the possibilities of design and product development together with the supplier is of great importance, and the aim is to further utilise the potential of supplier co-operation. This derives from the highly fashion influence the home textiles is exposed to and the development of patterns and designs of the product. As stated before, the agents today conduct much of the design, but the aim of the

Home Textile department should be to find suppliers where this process can be conducted in close relation with the supplier. In this case it is important that the supplier understands and can adapt to Scandinavian styles, and geographically closer markets can possibly adapt easier.

5.3.6.3 Concluding Remarks

It is of great importance to choose the right sourcing market for the intended product if desired to create a high involvement relation with the supplier. This is also in close connection with the establishment and incitements for a high involvement relationship with the supplier because of the learning process of the supplier to be able to understand and adapts to the purchasers' taste and design. As a consequence of a long relationship and a mutual dependence between the purchaser and the supplier co-operation in designs can be initiated. However, there could be other obstacles in the creation of a higher involvement relationship, like the cultural dissimilarities between markets.

5.3.7 Cultural Barriers

Cultural barriers nowadays have a different understanding as it did ten years ago. Today most business people are used to conduct business in a global perspective. Cultural barriers are no longer a new phenomenon but a part of daily business. English is becoming widely known, and also in China business, they starting to adapt their business culture to be more receptive to European. Cultural barriers are today no longer a convincing obstacle to trade, as the increasing opportunities that prevail in exploiting new markets is getting more important to survive competition. But, it would be misleading to say that cultural barriers no longer prevail or have any influences in the way that business is conducted. This analysis will focus on the concerns of cultural under standing and business ethics.

5.3.7.1 Cultural Understanding

Cultural understanding is essential when conducting business. Although, one must not adhere to the culture, but respect it on order to do successful business. Both China and Latvia has due to its history different cultural background compared to Sweden, though Latvia has stronger cultural bonds with Sweden than China which makes it somewhat easier to understand intentions and thought processes. Another important aspect is again, the size of China, which implies a huge variation of cultures within the nation. It is dangerous to view China as a homogenous nation, rather the purchaser has to be aware of the

immense cultural differences between for example the city of Shanghai and Guangdong Province. In China, it is also of utmost importance to specify every detail concerning the product and the production process. It is frustrating to do business when the risk and uncertainty of misunderstanding exist. For example, a Chinese supplier would rarely state that something is not possible, rather accept the deal and subsequent to that find a solution in accordance to the purchaser requirements, which as stated before can lead to quality reduction.

The issue of cultural barriers has in reality a rather big significance but in theory it should barely influence the sourcing decision. As the Home Textile product group purchase mainly from developing markets rather distant from the Swedish market cultural barriers have for all time affected it. However, cultural barriers should not be considered as an obstacle to trade rather a matter of importance in learning and adapting to the cultural differences.

5.3.7.2 Business Ethics

Business ethics today are probably something that is often taken for granted. Business ethics concerns the way of conducting business and the honesty integrated in the business deal. This cannot be related to any nation rather it is only applicable to the specific supplier; still, it is of utmost importance to take into consideration if aiming to establish a long-term relationship. Most companies are operating in a global environment and therefore the importance of adapting to each culture's business ethics is of greatest significance.

Business ethics are not considered of greater importance cornering the Home Textile department. As the trade has grown to be a global matter the issue of business ethics has become an instrument for surviving in an international perspective. However, the importance of adapting to certain business ethics may not be understandable in a Swedish perspective.

5.3.7.3 Concluding Remarks

One should never underestimate the differences in culture and business behaviours worldwide. This is most certainly highly prevalent in China, though it still exists in Latvia, and in order to conduct successful business, both parties must be involved in the relation in order to make it work and create a common understanding. It is important to consider that sometimes the smaller cultural differences can cause the greatest damage as one may overlook those attributes, i.e. some might consider Latvian culture similar to Scandinavian due to its

historical bonds and geographical closeness but differences still prevail. On the other hand, as the differences are so obvious between Sweden and China, more acceptances are occurring on the market.

5.3.8 Result of Supplier Selection Process

After reviewing both China and Latvia in the context of the Supplier Selection Model their strengths and weaknesses as well as opportunities and threats can easily be identified. These are shown below, in figure 26 and 27 and must be put in conjunction with the wants and needs of ICA Non-Food. China is today, and will remain in the future, an outstanding sourcing market. Most anything can be purchased within the market and a vast product offering already exists, and technological advancement of the products will rise.

<p>STRENGTHS</p> <ul style="list-style-type: none"> • Low-cost production • Huge labour pool, efficient workers • Vast market with enormous resources • Extensive product assortment • Business oriented people • WTO entrance – Increased transparency and pressure for liberalisation 	<p>WEAKNESSES</p> <ul style="list-style-type: none"> • Loopholes in the legal system, i.e. commercial law and social responsibilities • Geographical distance (transportation time and cost) • Product quality and quality control • Complex business structure, i.e. SOEs and trading houses • Risk of Patent Infringement • Lack of management skills, unable to exploit its R&D capabilities
<p>OPPORTUNITIES</p> <ul style="list-style-type: none"> • Huge future potential within labour intensive manufacturing as well as higher value-added production • Increased R&D • Improved stability and Business environment • Increased privatisation • WTO entrance – Liberalisation of trade barriers 	<p>THREATS</p> <ul style="list-style-type: none"> • Trade Restrictions • Lack of Infrastructure development • Social Responsibility • Decreased transparency of market due to increase trade barriers.

Figure 26; SWOT Analysis of China in Sourcing Perspective

However, it is apparent that China do have certain delimitation in its capabilities, and China must be complemented in several different aspects due to long transportation time, uncertainties of trade barriers (home textiles) and limited adaptation to the Swedish market and ICA Non-Food especially, due to

its small quantities. Once again the dilemmas of balancing the aim for cost focus versus risk reduction when screening for potential sourcing markets. The difficulty in China also arises when to find the right and trustworthy supplier, as there is an excess of array.

As indicated above, presence in China for sourcing activities is vital, as it is becoming the world factory of manufactured goods while still keeping low prices. The food retailing business where ICA Non-Food is operating is highly cost sensitive, and especially the Home Textile department. As consumers are price driven retailers must respond to their demands in order to gain customer satisfaction. This enhances the position of China as a potential sourcing market as it is highly cost competitive in combination with the quality offered. In theory China have the capabilities to capture most manufacturing production within retailing products but as the US and EU have interests of their own in these matters China needs to adapt to their demands, hence the need of a complimenting market, i.e. Latvia as seen below in the SWOT analysis.

<p>STRENGTHS</p> <ul style="list-style-type: none"> • Price-competitor within EU • Smaller suppliers, i.e. mutual benefit • Geographical closeness • Gaining knowledge of Scandinavian design and preference • Established Swedish Interest within the market • EU accession – Increased transparency and predictability 	<p>WEAKNESSES</p> <ul style="list-style-type: none"> • Loopholes in the legal system, i.e. corrupt and high bureaucracy • Limited market potential and lack of basic resources • Lack of entrepreneurial spirit and marketing skills • Lack of management skills, unable to exploit its R&D capabilities • Current exchange-rate
<p>OPPORTUNITIES</p> <ul style="list-style-type: none"> • Future potential within labour intensive manufacturing as well as higher value-added production • Increased value-added production • Improved stability and Business environment • Understanding of the Russian culture, mentality and language • EU accession – Structural funds 	<p>THREATS</p> <ul style="list-style-type: none"> • Rapid increase of wage and factor costs • EU accession - “Brain drain,” i.e. migration of skilled and educated workers • EU accession – Too much top control, i.e. little flexibility in domestic policies • Changes in industrial focus

Figure 27; SWOT Analysis of Latvia in Sourcing Perspective

Latvia offers a limited potential, both in quantity as well as product offering. Although, its strength derives from profiling itself as a cost-competitor within Europe, able to understand and adapt to the Swedish design and preferences, further visualised in the SWOT-analysis above.

EU accession will enable Latvia structural funds as well as cohesion funds, and this offers Latvia huge opportunities to build their future if invested correctly. The sourcing potential available in Latvia is as stated limited, though it is used as a case example within home textile whereas in other sectors other EU accession countries have a competitive advantage over Latvia and ought to be considered as potential sourcing markets.

Latvia's weaknesses and future threats include the questionable legal environment, lack of entrepreneurial spirit and rapid increase of wage and factor costs that will make it too expensive or risky to do business in Latvia. The intense price focus within home textiles, as well as the disadvantageous euro-dollar fluctuations, has put Latvia in a difficult position where it must push for other non-price factors in the supplier selection mode, i.e. order flexibility, local adaptation, and low exchange rate exposure as they conduct business in Euro.

Following the discussion above, it gives good indication that retailers, and ICA Non-Food, ought to spread their purchasing activities in between different markets in order to meet the diverse requirement of different product assortments, types and attributes. ICA Non-Food has a broad spectrum of products and different sourcing strategies prevail within each category, and as China and Latvia both possess certain competitive advantages, they ought to be carefully scrutinised in order to make a perfect fit between market and product characteristics.

In the case of the Home Textile department it was noted by the analysis that different products demand different levels of involvement of the suppliers. As this is directly connected to the analysis of the different criteria the products also require different aspects from the sourcing market and the supplier. In the initial analysis of the specific products the following result was presented:

Bed Sets:

Seasonal Product + ICA Own label + Simple Product = Low Involvement Relationship

(1 aspect indicated high involvement and this has to be taken into consideration)

Sheets:

Regular Assortment + ICA Own label + Simple Product = High Involvement Relationship

(1 aspect indicated low involvement relationship, but as the influence of the high involvement relationship is higher this does not change the aim)

The two levels of involvement, high and low, indicates different focus in regards to supplier and market characteristics and it can be noted in the discussion above that the requirements may differ even though the two products are considerably alike. In a low involvement relationship the aspects of Financial Aspects, Trade Restrictions, Perceived Risk and Quality Assurance are considered of highest importance. In addition, the aspect of on-time delivery can be included if there is a seasonal product, for example a Christmas campaign. In the case of sheets the analysis indicated a higher involvement relationship where factors like Service performance, Buyer-Supplier relationship and Cultural understanding increases in importance. This derives from the fact that sheets are part of the regular assortment and will be purchased regularly without major changes in design. In this case a stable relationship with the supplier is beneficial as flexibility in the order process as well as potential of shared R&D may be achieved.

As explained in the analysis China and Latvia possesses different competitive advantages when it comes to sourcing activities. In rational economic terms both of these products should be purchased in China but as the analysis includes other non-economical aspects it is clear that a complementary market in sourcing activities is preferable.

6 RECOMMENDATIONS

The importance of establishing a balanced sourcing solution is more important than finding the most cost competitive supplier in each single purchase. This is part of the answer given to the statement that ended the page above and also the analysis of the supplier selection model. As there are several aspects investigated in this study the recommendations will deal with the different aspects step-by-step, moving from a narrow perspective towards recommendations on a broader level. The recommendation will begin by answer the question of optimal sourcing solution for the two products, bed sets and sheets. Thereafter, based on the case study, recommendations will be given on Product Group level, overall ICA Non-Food level and finally conclude with specific recommendations to the Home Textiles department.

6.1 Supplier Selection Model – Bed sets and Sheets

The ending of the Supplier Selection Model indicated that if using rational economical reasoning, most all purchase activities within Home Textiles should be located in China, or another Asian low cost producer. However, this is not sound decision-making, as several non-economic aspects ought to influence the sourcing decision as different product characteristics pose different demands on the supplier as well as sourcing market. The in-depth study of bed sets and sheets in the analysis highlighted these concerns and indicated that the two products differ in characteristics and that different sourcing solution should be applied.

Based on the analysis it is recommended that the Home Textile department consider purchasing of bed sets from a cost oriented market such a China. On the other hand, sheets are preferably purchased from a market and a supplier where more emphasis could be put on risk-reduction and higher supplier involvement, in this case Latvia.

However, this raises the question of cost and what levels of cost increases that can be acceptable in a decision of sourcing from Latvia instead of China.

Bed sets are seasonal products and do not have strict requirements adhering to always be in stock as the designs differs between every season. Economies of scale and cost-minimization can be realised by single ordering of large bulks

from the Far East and China specifically. In the case of sheets, supplier flexibility, geographical closeness in terms of transportation time, and risk reduction attached to the purchase are of great concern. The reason behind this is the regularity of orders put to secure a constant supply of the regular assortment. In this case Latvia would be a superior sourcing market by its geographical closeness, possible adaptation to Scandinavian designs and a lower risk attached to the purchase.

6.2 Recommendations on Product Group Level

Further motivation and a discussion of the statement above will follow below, where recommendations are given to ICA Non-Food. The recommendations begin on a Product Group level, including some specific advices to the Home Textile department, and finally some recommendations to an overall organisational level be given. It is important to realise that in order to conduct successful global sourcing, not only must companies be aware of how to utilise the emerging market, is must also have a company structure supporting the international sourcing activities. Therefore, the authors will below present certain issues of concerns identified throughout the research.

- **Focus on Building the Product Assortment**

Lasester (1998) stated that one of the key steps to achieve successful sourcing is to “view the supply base rather as a result not the objective”. By this, he implied that the choice of products included in the product assortment would determine what suppliers that will be of interest. The importance of changing the focus of sourcing activities is thereby highlighted and has to be considered by ICA Non-Food. The first step of the sourcing process must be to build an assortment of products based on consumer demands and the over all strategy of ICA. As a second step, the right suppliers to the product range in the assortment will be determined. At present, the building of assortment is sometimes neglected and supplier offering can influence the product range within the product groups and in some cases include irrational decisions of products included in the assortment. It is recommended that ICA Non-Food focus on establishing a stringent product assortment both on an over all strategic level but also within each separate product group. It ought to be the product in the assortment that determines the supplier and nor the opposite.

- **Change Division of Responsibility**

As ICA Non-Food is growing, the internal organisation is changing. As the workload on each product group is increasing the solution has so far been to divide the product groups in smaller divisions. However, this is not an optimal solution in a long-term perspective as the coordination of Product Groups and Product Managers will be too complex. The division of responsibility within the Product Groups could instead be altered to utilise the knowledge and the strengths of each person. Today the Product Manager is responsible for both building the Assortment and to find the optimal sourcing solution. In a future perspective a better solution is to divide these operations between personnel in order to find a better focus in the division of responsibility. It may sometimes lead to conflict of interest when both building an assortment and having the economic responsibility for each purchase.

- **Create a Balanced Sourcing Solution**

ICA Non-Food needs to find a solution for achieving balanced sourcing in terms of establishing stability by combining and complement price focus with risk reductions. This must be achieved both on an overall strategic level as well as within each product group. Each product group should carefully view its product assortment and find an overall solution of sourcing for the entire product group, though, not stating that one sourcing solution fits all, but taken together all sourcing strategies should contribute to an overall balanced strategy reducing risk while still minimizing cost. Using this strategy, the majority of the products will be purchased with a strict cost focus, but some products, due to its characteristics can reduce the cost orientation and replace it with risk reduction focus when choosing suppliers. By risk reduction, it is not only the political and economical risk on the market that is included but also risk related to the purchase in it-self. Examples could be risk of late delivery because of geographical distance, risk related to product quality because of low control over production process and risk connected to ethical control of the supplier.

It is already stated that by applying rational economical decisions almost all sourcing activities would be conducted in China and other related markets, but if so conducted, the overall risk would be great. As a response to the dynamic, unstable and relatively high-risk markets like China, the sourcing activities need to be complemented by more stable sourcing activities with less risk attached to the sourcing activities. It is not said that this cannot be achieved in

China but it is more easily achieved in geographically closer markets. There are two approaches for ICA Non-Food to consider when dealing with this concern:

1. Assortment Balancing

This refers to a balancing of sourcing of different products on different markets. As the analysis showed, different characteristics of the products, requires different sourcing solutions, which can be provided by different markets. For example, products within the regular assortment are preferably purchased under more risk free condition in geographical proximity. In this study this was highlighted by the recommendation of buying bed sets from China and sheets from Latvia, which leads to a balanced sourcing solution.

2. Complementary Balancing

This refers to the importance of a stable product supply which is reached by placing large bulk orders in cost-advantageous markets like China and complementary orders in geographically closer markets like Eastern Europe, and in this case Latvia. By utilising this strategy, the concern of ordering too large quantities can be reduced by purchasing the “most likely” quantity from China and then be complemented if needed from producers in Latvia. This would reduce the amounts of goods sold at reduced costs (sales) due to excess inventory, hence increasing the profit margins for ICA. Several retailers, especially within clothing industry where time-to-market is of utmost importance, apply this thinking as changes within fashion increases the uncertainty of what quantities that will be sold and consequently difficulties in determining correct order quantity. Though, the quantity of home textiles purchased by ICA Non-Food may not yet be large enough to implement this thinking, but as quantities increases, this ought to be put into consideration.

• Establish a Set of Suppliers

This aspect is connected to the first recommendation, of building a product assortment and chose suppliers thereafter. If this is achieved it is recommended to find a set of supplier to work with regarding products purchased in a transactional mode, connected to low involvement supplier relationship, which is often linked to cost-sensitive purchases in markets like China.

It is recommended to find a network of potential suppliers within each product niche to engage in deeper discussion with. The screening of potential suppliers should be conducted thoroughly and with a consideration of potentially creation of longer relationship in a time perspective. The producers can be situated in different markets but preferably as few markets as possible, as a too

large spread makes it difficult to handle. By focusing on a limited number of producers and upholding these contacts, gains will derive from savings in regards to both time and cost spend on supplier visits, quality control and price negotiations.

- **Increased Attention on Market Screening**

The dynamics of global trade and the continuous evolution and growth of emerging markets are increasing the importance of market screening. An optimal sourcing solution today can be outdated tomorrow, though the parameters of the sourcing strategies will still be valid, but performed differently. It is therefore recommended to ICA Non-Food and each Product Group to emphasise more on market screening in order to be prepared for future opportunities, and to establish the company as a leader instead of a follower in terms of sourcing. By constantly being prepared on potential opportunities and threats prevailing on emerging markets, economies of scale can be reached by enhancing the opportunities before the competitors does. As mentioned in the previous chapter, Latvia represents a good complementary sourcing solution to China, by having manageable risk and still cost-efficient production. However, it is stated in the report that its competitiveness will decrease as the factor costs increases and as a consequence product prices will increase. Therefore, the importance of screening for new potential complementary sourcing markets is of importance as prevailing opportunity is moving eastward into Russia and the CIS countries.

- **Long-term Focus on the Sourcing Strategy**

The aim of the sourcing strategy within each Product Group must have a long-term focus. This should not be confused with establishing a long-term relationships with suppliers but refer to a long-term focus of the overall sourcing strategy. ICA Non-Food is recommended to look beyond to pure economic rational behind each purchase and include other aspects presented in the Modified Supplier Selection Model. There are costs attached to each switch of supplier that is not included in respective product calculation, and therefore not visible in the underlying economical decision for each purchase. The switching costs of alteration of suppliers include cost and time for quality control, factory visits, the negotiation process and ethical control of supplier. In addition, the time spent on learning about the supplier and get acquainted with the supplier should not be neglected. It is therefore recommended for ICA Non-

Food to always consider a long-term potential in a supplier if engaging in trade, to be able to reduce the switching costs.

6.3 Specific Recommendations to Home Textiles

- **Increased Attention to Long-term Strategy**

The Home Textile products are highly price sensitive, which makes the concern of sourcing more delicate than in other product groups. In addition the number of external factors like tariffs and other trade barriers make the sourcing activities more unstable and exposed to uncertainties.

As a natural response to the dynamic, relatively high-risk markets, like India and China, the Home Textile department has applied an ad hoc sourcing strategy, highly influenced by the fluctuations of the dominant exchange rates, i.e. Euro-dollar parity. It is highly recommended to the Home Textile department to look beyond pure transactional modes of purchasing. High involvement relationships do not need to be achieved, but it should be remembered that supplier loyalty could pay off in lower prices. At present the sourcing activities within the Home Textile department is rather improvised, continuous negotiations for best-price solutions in respective purchase. By engaging in ad hoc strategies high expenditures are incurred from factory visits and negotiation processes, as there are switching cost connected with the changing of suppliers. It is therefore recommended to evaluate current suppliers and decide on a good representative group of suppliers, which can be utilized in a longer time perspective.

- **Focus on Direct Contact with Suppliers**

If a long-term strategy can be imposed and Home Textiles will find a stable network of suppliers to work with, focus can be pointed towards a direct contact with the suppliers. By creating a sourcing strategy built on a limited collection of producers the incitements of using an agent decreases, as most purchasing activities within Home Textiles is conducted through an agent at present. This will initially reduce cost of sourcing activities with 3-5 percent, which is the cost of the agent. This raises the question of designs and development of new models, which is currently mainly developed by the agents. It is recommended to investigate a cooperation with the clothing

department within ICA Non-Food how has own designers which potentially can assist in the development of home textile designs.

- **Regular Screening of Trade Barriers**

As mentioned earlier home textiles are highly sensitive to the development of trade barriers. This is probably the highest risk attached to the sourcing activity and it makes the sourcing extremely unpredictable and non-transparent. As the phase out of textile quotas will take place during 2004 the following years will probably be resplendent with an increase of anti-dumping tariffs, anti subvention tariffs and safeguard measures. However, if time and effort can be put in following the development of external trade within the European Union, the risk of surprises will reduce. All potential additional tariffs will be presented in the in the EU Official Journal approximately one year before a potential tariff will be imposed, as the investigation starts. As most investigation lead to an introduction of a tariff the Home Textile department can start screening for complementary suppliers long time before the tariff is introduced.

6.4 Recommendations on Strategic Level

- **Central Management of Assortment Strategy**

The importance of building a products assortment within each products group, as mentioned earlier is absolutely applicable to the overall strategy of ICA Non-Food. As it is important to build a product assortment within each product group, the same concerns the overall product assortment of ICA Non-food whereas balance and a complementary assortment must be achieved in order to offer consumers a satisfactory array of quality products to a fair price. The product assortment within ICA Non-Food has to be formed on a strategic level, and than implemented in each Category Level and further to the Product Groups.

It is recommended for ICA Non-Food to review its assortment and clearly categorise its products and strategy prevailing in the next coming years. Of most importance are the private labels as they are of high concern in this study. In order for ICA Non-Food to find an optimal sourcing strategy a clear understanding of the opportunities and threats connected with the private labels must be achieved. A common aim and focus concerning the private labels must

be developed and implemented within all Product Groups of ICA Non-Food to secure a common view and an even quality standard of ICA Non-Food's own products.

- **Balanced Sourcing on a Central Strategic Level**

The formation of an optimal product assortment, as mentioned above, will as a second step be divided into the different products groups to form a balanced sourcing of ICA Non-Food, in terms of cost focus and risk reduction. Some product groups are more risk related, as the Home Textiles, and others are optimal for cost reduction, as Cleaning Products. It is the upper managements responsibility to provide guidelines and responsibilities to the different product groups to work with and to form an overall balanced sourcing solution.

After reviewing both China and Latvia in the context of the Modified Supplier Selection Model their strengths and weaknesses were easily identified, but it is also important to put them in conjunction with the wants and needs of ICA Non-Food. China is today, and will in the future, remain an outstanding sourcing market, in terms of cost-advantage. However, it is obvious that China do have certain delimitation in its capabilities, and it must be complemented in several different aspects due to long transportation time, uncertainties of trade barriers and the production quantities produced. Large-scale labour intensive production ought to be placed in China, and especially in regards to the seasonal assortment but also the base assortment. As the large bulks of import are located in the Far East, it makes sense to locate certain base assortment, as well as complimentary orders, closer to the home market.

- **Increased Coordination Between Product Groups**

As stated in the analysis the Product Managers are working independently in the creation of sourcing solutions. Much of ICA Non-Food's success derives from motivated Product Mangers, enjoying high level of decision-making authority. Though, in a short-term this is a functioning strategy, but in a long-term perspective, and as competition further intensifies, it is of great importance to create an adherent ICA Non-Food sourcing strategy by which all product groups are involved. ICA Non-Food needs to find a solution of maintaining and sharing the embedded knowledge within each Product Manager to transfer it within the company, as this would increase efficiency

and secure that the competencies of the human resources will remain firm-specific competencies as it is shared among the personnel.

- **Increased International Focus**

To secure a long-term success of ICA Non-Food and to provide a competitive situation within the overall Ahold cooperation, an increased international focus has to be developed. As ICA Non-Food is stated to potentially be the main sourcing organ of Ahold non-food products, the international focus within the non-food division has to increase. It is recommended that ICA Non-Food change the view on its international operations. As today, the focus is on selling to the other markets but the view ought to be altered to become the sole purchaser for the other markets. ICA's strategy should be to develop an assortment in conjunction with the international retailers and satisfy some of their products requirements in order to secure their loyalty and gain larger and more stable quantities in their purchasing activities. In this way the whole ICA Group will experience economies of scale, prices will decrease and a stable assortment can increase its competitiveness in Sweden but also in Norway, Denmark and Baltic States.

- **Central Evaluation of Result**

At present the evaluation and follow-up of the result within ICA Non-Food is missing. There is a lack of lack of statistical analysis of previous result and even if the statistics is available it is not utilized by the different Product Groups. ICA Non-Food also needs to develop and implement core values, to make sure that all Product Groups are aiming at the same goal, in qualitative terms. The aim of the private labels is to "provide the same or better quality as the market leader, but to a lower price", which is a rather broad aspire. In the case of Home Textiles no clear market leader is established, hence difficulties arise in the product development.

It is also important to not only focus on cost reduction or sales increases in each Product Group but to also consider the over all adaptation to ICA Non-Foods core values in the development of assortment, but most of all the development of private labels. This work should not be conducted by the controller function but rather by the upper management and a central function responsible for coordination between the different Product Categories and Product Groups.

7 CONCLUSIONS

After the presentation of a theoretical approach to international sourcing in chapter 3, an empirical description of retailing and the two investigated markets in chapter 4, followed by the previous presented supplier selection analysis and recommendations we would like to refer back to the main problem formulation:

How should retailing companies conduct and balance its sourcing activities in order to respond to new operating conditions and utilize the dynamics of emerging markets?

The research has shown, through the case study approach, that the dynamics, opportunities and threats prevailing in the investigated market of China and Latvia are immense. Consequently, it is clear that retailers need to adapt its sourcing strategies in order to take advantage of the future prospects of potential sourcing markets. Although, what has been noticed is that it is not only the sourcing strategy in isolations that creates successful sourcing, rather a holistic perspective of the organisational structure of businesses. By encompassing product strategy, long-term visions and efficient division of labour the conditions for the creation and carrying out of a successful sourcing strategy are enhanced.

The current economical and political geography of the world is changing dramatically as a consequence of EU Enlargement and the recent WTO accession of China. Today, the world can be viewed as a highly dynamic setting continuously offering new imperative for competition and trade. Hokey Min developed his Supplier Selection Model in 1994 as a response to the turbulent world and its dynamic forces; the official formation of the European Community, the end of Communism in the Eastern Bloc Countries and the pending approval of the North America Free Trade Agreement. The argument pressed is that, “yes we do live in a turbulent world today, providing both great opportunities as well as threats for businesses, but there is nothing stating that the world in the future will not remain dynamic”.

All nations possess competitive advantages, though it must be put in context to each other. China and Latvia enjoy totally different competitive advantages as visualised the SWOT-analysis in figure 26 and 27. As the emphasis in this research is on emerging markets, the transitional period consequently increases

the dynamics and unpredictability within the markets, which make it important to analyse present and potential sourcing markets, to predict future opportunities and threats. There is an important trade-off in international sourcing between risk reduction and cost maximisation, which must be considered by firms.

Even if it is commonly recognized that globalisations of trade is a fact and that free trade should be an aim of all markets the reality shows a slightly different picture, where new tools of industry protection like anti-dumping anti-subsidisation and safeguard measures, are increasing. Furthermore, rationalisation trends reverse many of the trade liberalisation treaties previously undertaken, with the consequence of increases complexity and uncertainties of the markets. In the case of textile industry, the phase out of the MFA Agreement in 2005 will probably be followed by numerous protective actions from markets like the US and EU. This reduces the predictability of the markets, with severe consequence on sourcing activities, as purchasing prices are directly connected to the presence of tariffs, and these vary on the markets.

However, a key factor for successful sourcing is not only to understand the dynamics of emerging markets, but also the product assortment and its characteristics, in order to know what to search for when conducting sourcing on the global market. The analysis, based on the Modified Supplier Selection Model, showed the example of bed sets and sheets that had different characteristics and therefore a complementary sourcing solution was preferable. The analysis further discussed the applicability of the case study in a broader perspective and stated that the strategies of complementary sourcing solutions were applicable to numerous product groups within ICA Non-Food.

The extensive changes within the retailing industry, explained in chapter 4.1, including increased number of private labels, and elimination of the middleman between the buyer and supplier, increases the importance of establishing an internal sourcing strategy within the company. The characteristics of the product have to be considered, and in addition, the preferable level of involvement with the supplier. Different products characteristics require different level of supplier relationship and this in turn leads to additional requirements demanded of the potential market and supplier. In addition, previous experiences within sourcing and product development make sourcing activities more flexible and firms are more proactive in their strategies. In this

way the retailer can adapt to changes more quickly as new opportunities prevail in surrounding markets, hence experience is essential in conducting successful sourcing.

The model presented by the authors facilitates for companies to open up their eyes for new markets and also the opportunities prevailing in sourcing activities. As few firms view the whole “value chain” of sourcing, it is easy to overlook important steps on the way. By using the Modified Supplier Selection Model, firms can gain an increased understanding of the attributes involved in sourcing, and more specifically, the complex trade-off between cost focus and risk reduction. Neither mode is inappropriate to conduct, though firms must consider rationalising their operations and widening their views in their sourcing strategies in terms of both financial and non-financial aspects in order to utilise the markets full potential.

As the case study of ICA Non-Food and the Home Textile department showed, there are incentives indicating that there can be cost savings of adapting the company sourcing strategy in order to utilize the opportunities in emerging markets. By structuring the sourcing activities and balance the dilemma of a cost orientation versus risk reduction in the sourcing strategy, markets with different characteristics can be utilized in a better way and better use of resources will be achieved.

In conclusion, retailing companies have to balance its sourcing activities in different markets to reduce the risk and uncertainty of one market abruptly reduces its attractiveness. The balance of sourcing could be conducted in different ways based product characteristics and level of involvement with the supplier, and this research has pointed out two different conditions prevailing for sourcing synergies. Firstly, **Assortment Balancing**, which refers to a balancing of sourcing of different products on different markets. Secondly, **Complementary Balancing**, which refers to placing huge bulk orders in cost-advantageous markets complementary orders in geographically closer markets like Eastern Europe, and in this case Latvia.

To conclude, we will go back to the quotation where we started “A great wind is blowing and that give you either a headache or imagination”. This thesis has shown that possibilities prevail for firms to succeed by utilizing the wind of change. The key success factors for retailers in the future does not only exist in

finding new solutions for customers, but also improving the left-hand side of the value chain and enhance the product offerings, this best conducted by developing an effective and balanced global sourcing strategy.

7.1 Suggestions for Further Research

- **Internationalisation By Sourcing**

In theoretical literature and articles the internationalisation process is to a large extent focused on internationalisation by market entrance and deals with different sorts of entry modes. We believe that is it a need of research conducted in the process of internationalisation by sourcing activities and to further investigate if previous internationalisations theories are applicable to the concern of sourcing.

- **Free Trade or Hidden Agendas**

The major risk connected to trade within our case study has been the uncertainty and dynamics of the existence of tariffs and non-tariff barriers, and the approach by which EU and US uses to impose new protectionist actions. Even if there is an intense discussion prevailing, there is a lack of research conducted of what consequence these protectionist action will have on global trade. As the quotas should be diminished by 2005, it is interesting to investigate the potentials and the affects of this process.

- **Supplier Selection Model**

As discussed in the methodological chapter, Yin (1994) explains the importance of applying a theoretical view of a case study to increase the validity and motivate generalisation. He further emphasises the importance of applying the theoretical model several times, which further increases the possibility to draw conclusions of the specific research area. It would be recommended for researchers within the same research area as in this study, to apply The Modified Supplier Selection Model in their study in order to evaluate the applicability of the model and to increase the possibilities for generalisation within the research area.

- **Coordination of Sourcing Activities within Retailing**

In the case of ICA AB and ICA Non-Food investigation of the coordination of sourcing activities is of utmost importance. There is a strong tendency of an international restructuring process within the retailing industry, including several merges and acquisition, and research concerning how the sourcing activities can be utilised by coordinating the sourcing activities between the retailers within the same organisation in needed. This process will most likely be increasing in the near future and an investigation on the affects and potential of this concern is of greatest interest.

- **Representative Office or Not**

The last aspect of further research only concerns ICA Non-Food and refers to a strategic analysis of the potential of establishing a representative offices in China to handle the increasing number of purchasing activities on the market. Initially, it was mentioned in the proposal by the authors but it was not regarded an option based on ICA Non-Food's low turn-over, compared to other retailers on the market. However, as the turnover of ICA Non-Food is almost the same as the turnover of Åhlens, it is still believed that it should be considered, at least in a future perspective. Åhlens, is a Swedish retailer with similar product assortment as ICA Non-food and decided about 10 years ago to open a representative office in China, which nowadays has been transformed into a purchasing office. This can indicate that a similar solution could be beneficial for ICA Non-Food in a future perspective.²⁰⁶

²⁰⁶ Peterson, Jonas, Chief Representative, Åhlens Far East in Shanghai

8 REFERENCE LIST

Monograms and Scientific Articles

Babbar S and Prasad S (1998) International purchasing, inventory management and logistic research, *International Journal of Physical Distribution & Logistic Management*, Vol. 28, Issue 6

Balfour Frederik & Roberts Dexter (2003), Is China's Boom In Danger? *Business Week*, Nov. 3, 2003, Issue 3856, p 48-51

China & North East Asia Monitor (2003), *Country Risk Summary: CHINA*, Nov 2003, Vol. 10 Issue 11

Clifford Mark (2002), Bankrupt Logic About China's Debt, *Business Week* November 22, 2002 (Business Week On-line)

Cooper James & Madigan Cathleen (2002), Exports Are a Continuing Source of Power, *Business Week*, July 29, Issue 3793, p30

Cronbach L J (1975), Beyond the two disciplines of scientific psychology, *American Psychologist*, 30, 116-127

Elg Ulf & Johansson Ulf (2000), *Dynamiskt Relationsbyggande i Europa*, Team Offset & Media, Malmö

Engeseth, Stefan (2002), Swede Smell of Success, *In-Store Marketing*, Nov 2002, p15

Fine, Charles et al. (2002) Rapid-Response Capability in Value-Chain Design, *MIT Sloan Management Review*; Vol. 43 Issue 2

Frear, Carl R, Alguire, Mary S (1995) Country segmentation on the basis of international purchasing patterns, *Journal of Business & Industrial Marketing*, Vol. 10 Issue 2, p59-69

Gilliam, Margareta (2001) Is retailing entering a new era, a tougher era? *Retail Merchandiser*; Vol. 41 Issue 5

- Dicken, Peter, *Global Shift; Reshaping the Global Economic Map in the 21st Century*, 4th Edition 2003, SAGE Publishing Ltd., London
- Ford, Davit et al. (2002), *The Business Marketing Course - Managing in Complex Networks*, Biddles Ltd., Great Britain
- Georghantzas, Nicholas V. & Acar William (1995), *Scenario Driven Planning – Learning to Manage Strategic Uncertainty*, Greenwood Publishing Group Inc. USA.
- Giunipero, Larry C. (1997) Organisational approaches to managing international sourcing, *International Journal of Physical Distribution & Logistic Management*, Vol. 27, Issue 5
- Johansson Ulf (2002), Food retail buying process – a study of UK, Italy and Sweden, *International Journal of Retail & Distribution Management*, Volume 30, Number 12
- Laseter, T. (1998) *Balanced Sourcing*, Jossey-Bass Publishers, San Francisco
- Liebmann, Hans-Peter et al. (2003) Innovations in Retailing: Gradual or radical innovations of business models, *European Retail Digest* Mar 2003 Issue 37, p55-61
- Mercado et al. (2001) *European Business*, 4th Edition, Essex, Prentice Hall
- Merriam Sharam B. (1988) *Case Study Research in Education*, Jossey-Bass Inc. Publisher, San Francisco USA / *Fallstudien som forskningsmetod* (1994) översättning: Björn Nilsson
- Min, Hokey (1994). International Supplier Selection, *International Journal of Physical Distribution & Logistics Management*.
- Marknadsplats Östersjön, Nummer 18, 2003
- Nolan, Alexis (1999) Purchasing's new power, *Director*, Feb. 1999, Vol. 52 Issue 7, p46-50

Patel R. & Davidson B. (1994), *Forskningsmetodikens grunder – Att planera, genomföra och rapportera en undersökning*, Studentlitteratur, Lund

Roberts, Dexter (2000), China's Wealth Gap, *Business Week* May 2000 Issue 3681, p172-178

Sköldberg Kaj & Alveson Mats (1994), *Tolkning och reflektion; vetenskapsfilosofi och kvalitativ metod*, Lund, Studentlitteratur

Swedish Trade Council - *Marknadsplats Östersjön* Lettlands Centralbank höjer sina förväntningar, Nummer 18, 2003

Trent, Robert J. (2002) Pursuing competitive advantage through integrated global sourcing, *Academy of Management Executive*, Vol. 16, Issue 2

Videll Annica (2003), National Board of Trade, Sweden, *Kina som medlem I WTO – 18 månader efter anslutningen*

Zoubir Yahia H. & Lhabitant Francois-Serge (2003), *Doing Business in Emerging Europe*, Antony Rowe Ltd., Chippenham and Eastbourne, Great Britain

Walters, D. and Hanrahan J. (2000), *Retail Strategy Planning and Control*, MacMillan Press LTD, London

Yin Robert K. (1994), *Case Study Research – Design and Methods*, Volume 5, SAGE Publications, New Delhi

Reports

ACTE (Asociación de Colectividades Textiles Europeas), *Action plan for the European Textile Industry*, 2002

Ministry of Economics (June 2003), *Economic Development of Latvia*, Republic of Latvia, Riga

Confederation of Danish Industries (2003), *A brave new region? – Removing Barriers to Business in the Baltic Sea Region*, Kailow Graphic

International Textiles and Clothing Bureau (2003), *Summary of studies and reports on the impact of textiles; quotas elimination*

Kim Eng Securation (July 2001) *Sector Report, The Textile Emperor*

Kok Wim (2003) *Enlarging the European Union-Achievements and Challenges*, European Commission

Latvia Development Agency, Association of textile and clothing industry (2002), *Textile Industry of Latvia*

Latvian Development Agency (2003), *Latvian Export & Import Directory*

Latvian Development Agency (2003), *Latvian Business Guide*, Jana Seta Printing Group

OECD Organisation for Economic Co-operation and Development (May 2003), Working Party of the Trade Committee, *Liberalising Trade in Textiles and Clothing; a Survey on Quantitative Studies* (Peter Walkenhorst, Trade Directorate)

Ministry of Education and Science in Latvia (2003), *Research Directory*, Publishing House AGB

Ministry of Economics Republic of Latvia (2003), *Economic Development of Latvia*, Riga June 2003

Swedish Trade Council (2003), *Country Report China*, Foreign Ministry of Sweden

Swedish Trade Council (2002), *Country Report China*, Foreign Ministry of Sweden

WTO World Market Analysis (2002), *Country Report China*

WTO (1), World Trade Organisation (July 2003) (1), General Council, *Trade in Textiles and Clothing; Developing Member Concern, about Potential Reduction in Market (Quota) Access in 2004*, 29 WT/GC/W/503

WTO (2), World Trade Organisation (July 2003) (2), General Council, *Anti-dumping Actions in the Area of Textiles and Clothing*, WT/GC/W/503

IMF, International Monetary Fund (April 2003) *World Economic Outlook*

Internet Sources

Cambridge University – Department for Manufacturing Homepage

<http://www-mmd.eng.cam.ac.uk/people/ahr/dstools/paradigm/valuch.htm>, 2003-11-03

China Unique Homepage – www.chinaunique.com

<http://www.chinaunique.com/business/sez.htm> 2003-10-30

China Internet Information Centre Homepage – www.china.org.cn

www.china.org.cn/english/Political/25060.htm 2003-11-04

European Union Homepage – www.europa.eu.int

http://europa.eu.int/comm/regional_policy/newsroom/index_en.htm 2003-11-28

International Monetary Fund (IMF) Homepage – www.imf.org

<http://dsbb.imf.org/Applications/web/gdds/gddscountrycategorydcreport/?strcode=CHN&strcat=ESPT0> (1) 2003-11-25

<http://www.imf.org/external/np/exr/facts/sdr.htm> (2) 2003-11-25

Market Access and Compliance Homepage – www.mac.doc.gov

<http://www.mac.doc.gov/eebic/cables/1999/dec/rig4177.htm> 2003-11-19

Ministry of Economy, Republic of Latvia – www.lem.gov.lv

http://www.lem.gov.lv/En/News/Reports/99/2/3_5_3.stm 2003-11-25

Ministry of Foreign Affairs in the Peoples Republic of China Homepage –

www.fmprc.gov.cn

<http://www.fmprc.gov.cn/eng/ljzg/zgjk/3579/t17851.htm> (1) 2003-11-05

<http://www.fmprc.gov.cn/eng/ljzg/zgjk/3579/t17847.htm> (2) 2003-11-05

Statistics Sweden (Statistiska Centralbyrån, CSB) Homepage - www.scb.se

The International Herald Tribune Online – www.iht.com

<http://www.iht.com/articles/78340.html> 2003-12-03

Wikipedia Internet Encyclopaedia Homepage – www.wikipedia.org

[http://en.wikipedia.org/wiki/Gang_of_Four_\(China\)](http://en.wikipedia.org/wiki/Gang_of_Four_(China)) 2003-11-16

World Bank Homepage – www.worldbank.org

http://www.worldbank.org/data/databytopic/GDP_PPP.pdf (1) 2003-11-25

http://econ.worldbank.org/files/26157_cer_ineq.pdf (2) 2003-11-25

http://www.worldbank.org/poverty/data/2_8wdi2002.pdf (3) 2003-11-25

http://www.worldbank.org/data/databytopic/GDP_PPP.pdf (4) 2003-11-25

http://www.worldbank.org/poverty/data/2_8wdi2002.pdf (5) 2003-11-25

World Market Analysis Database – Country Report China –

www.worldmarketanalysis.com

<http://www.worldmarketsanalysis.com/servlet/cats?ID=11201&serviceID=21&typeID=1&pageContent=countryReportSection> 2003-11-10

World Trade Organisation Homepage – www.wto.org

http://www.wto.org/english/res_e/statistics_e/its2003_e/section3_e/iii75.xls 2003-11-03

Yahoo Finance - <http://finance.yahoo.com>

Additional Information Sources

Attendance to the Baltic Development Forum, Summit in Riga, 5th and 6th October 2003

Attendance to the Canton Fair 2003 16th, 17th and 18th October 2003

China's statistical yearbook 2002, 21st Edition, China Statistical Press

Euromonitor 2003

ICA Internal Homepage

Leverantörshandbok ICA 2003:1

Interviews

Alasheyeva, Julia, Baltic International Centre for Economic Policy Studies (BICEPS), Latvia 30th of October

Andersson, Dennis, Business Controller, ICA Non-Food, 2nd of November 2003

Avotins, Valdis, Director of Export promotion Department, Latvian Development Agency, 29th of October 2003

Bauer, Anders, Director, Department of Asia and the Pacific, Ministry of Foreign Affairs, Sweden, Stockholm, 6th of November 2003

Bengtsson, Catrin, Product Manager, ICA Non-Food, 25th of September 2003

Bågenholm, Andreas, PhD Candidate, Department of Political Science, Gothenburg University, 16th of September 2003

Bölling, Hans, International Freights and Customs Manager, ICA AB Stockholm, 21st of November 2003

Cauntis, Karlis, Executive Director, Foreign investors Council in Latvia, 29th of October 2003

Chow, Samson, Shanghai Konglong Textile Ornaments Co.,Ltd., Shanghai 22nd of November 2003

Daag, Hans, Deputy Director, Ministry for Foreign Affairs, 6th of November 2003

Danusevics, Henriks, Chairman, Latvian Traders Association, 2nd of November 2003

Detlof, Helena, Specialist Antidumping, National Board of Trade, Stockholm Sweden, 21st of November 2003

Edberg, Karl, Special Adviser, Office for project Export, Ministry of Foreign Affairs, Sweden, Stockholm, 6th of November 2003

Ekholm, Karolina, Assistant Professor Department of Economics, Stockholm School of Economics, 7th of November 2003

Engvall, Lieselott, Product Manager, ICA Non-Food, 25th of September 2003

Erikson, Christina, Product Manager, Home Textiles, ICA Non-Food, Frequent Dialogue during research process

Friberg, Stig, Trade Commissioner, Swedish Trade Council in Latvia, 30th of October 2003

Gabrielsson, Ulla-Britt, International Trade (Imports), Svensk Handel, Stockholm, 5th November 2003

Hähnel, Fredrik, General Manager – East China, Swedish Trade Council, Shanghai 20th of November 2003

Jiang, Caroline, Industry Dept. project Manager, Shanghai Foreign Investment Development Board, Shanghai 20th of November 2003

Kacija, Rita, Marketing Manager, Mezroze, 1st of November 2003

Karlsson, Gunilla, Counsellor, Swedish Embassy of Riga, Latvia, 3rd of November 2003

Karringer, Håkan, Market Assistant, Swedish Trade Council, Shanghai 20th of November 2003

Kocins, Viestur, Head of European Union Department, Latvian Chamber of Commerce and Industry, 3rd of November 2003

Kullbergs, Viktors, Chairman of National Economy Council, Ministry of Economics in the Republic of Latvia, 29th of October 2003

Kullvik, Marie, Category Manager, 26th of September 2003

Lundin, Linda, Product Manger, ICA Non-Food, 25th of September 2003

Liang, Eugene, General Manager Canton Fair Import & Export Co. Ltd,
Guangzhou 16th of November 2003

Magni, Robert, Sales Manager, C. Jahn AB, Contact during filed trip in China

Martinsson, Per-Ola, Logistics, ICA Non-Food, 12th of November 2003

Neimane Jadviga, Light Industry Expert, Latvian Development Agency, 29th of
October 2003

Nilsson Sofie, Information Manager, Swedish Trade Council, Shanghai 20th of
November 2003

Nilsson, Per-Ola, Product Manager ICA Non-Food, 24th of September 2003

Norlin, Bo E., Special Adviser, Trade Development and Promotion,
Department for Central and Eastern Studies, Ministry of Foreign Affairs,
Sweden, Stockholm, 6th of November 2003

Nordén, Charlotte, Category Manager, 11th of September 2003

Patek, Stanislaw, Ambassador, International Trade, Ministry for Foreign
Affairs, Sweden, Stockholm 7th of November 2003

Pauna, Diana, Pro-Rector, Stockholm School of Economics in Riga, 30th of
October 2003

Persson, Kurt, Product Manager, 22nd of September 2003

Petersson, Stefan, Category Manager Kitchen & Home, ICA Non-Food,
Frequent Dialogue during research process

Persson, Daniel N., Coordinator A-brand synergies, ICA AB Stockholm, 21st of
November 2003

Peterson Jonas, Chief Representative, Åhlens Far East in Shanghai, 22nd of November 2003

Petzäll, Lennart, Consultant, Cathay Consulting Ltd. Shanghai 24th of November 2003

Rydberg, Jonas, Purchasing Director - ICA Buying, Food, ICA AB Stockholm, Frequent Dialogue during research process

Samuëllson, Robert, Product Manager, 25th of September 2003

Skager, Lars-Åke, First Deputy Lord Mayor, professor, City of Gothenburg, 8th of October 2003

Svedberg, Marcus, Chief Analysis, Stockholm Institute of Transition Economics (SITE), 7th of November 2003

Strazds, Guntis, President of Association of Textile Industries, Latvian Development Agency, 29th of October 2003

Törnqvist, Erik, Category Director, ICA Non-Food, Frequent Dialogue during research process

Uhrlander, Mats, Category Support – International Relations ICA Non- Food, 22nd of September 2003

Wernborg, Jens, General Manager – South China, Swedish Trade Council, Guangzhou 16th of November 2003

Westman, Gunnel, International Trade (Imports), Svensk Handel, Stockholm, 5th November 2003

Yan, Frank, Market Consultants, Swedish Trade Council, Shanghai 23rd of November 2003, 2003

Zhang, Charles, Manager Commodities & Trade Finance and Sales, Australia and New Zealand Banking Group Limited, Shanghai 23rd of November 2003

Zhu, Paulo, President, Hangzhou Samsung Down Products Co., Ltd, Hangzhou
21st of November 2003

Zunda, Vita, Office Manager, IMF Riga, 3rd of November 2003

Åkerberg, Christer, Country Manager Latvia, ICA Baltic AB, 2nd of November
2003

Örn, Cleas, Product Manager, 24th of September 2003

9 Appendix

Appendix I – Changes in Tariffs after 2004

Table 3: Structure of EU pre- and post-Uruguay Round tariffs in the textiles and clothing sector
(in per cent)

Pre-Uruguay Round (1994)				Tariff rate distribution (in per cent)										
	HS lines	Mean	CoV*	0-2	2-4	4-6	6-8	8-10	10-12	12-14	14-16	16-18	18-20	20-22
							11.							
Textiles	3943	10.1	0.26	0.8	0.3	2.7	2	6.6	64.9	6.1	4.6	2.8	0.0	0.0
Clothing	447	12.3	0.26	0.4	1.1	5.6	4.7	5.4	2.7	13.6	66.4	0.0	0.0	0.0
All manuf.	17760	6.5	0.53	6.8	5.2	29.7	22.3	11.3	17.0	3.6	3.2	0.7	0.0	0.2
Post-Uruguay Round (2004)				Tariff rate distribution (in per cent)										
	HS lines	Mean	CoV*	0-2	2-4	4-6	6-8	8-10	10-12	12-14	14-16	16-18	18-20	20-22
Textiles	3941	7.3	0.25	0.9	0.4	16.2	2.5	68.0	8.1	2.7	0.5	0.8	0.0	0.0
Clothing	447	10.6	0.29	2.0	6.3	1.1	3.1	5.6	1.8	72.7	7.4	0.0	0.0	0.0
All manuf.	17324	4.0	0.96	14.6	27.4	24.6	11.4	17.7	2.8	3.1	0.6	0.4	0.0	0.0

*) Coefficient of variation.

Source: Spinanger (1999b).

Appendix II - Combination of Scenarios

As stated in the report, the aim of the scenario analysis is to provide a position of which the following supplier selection analysis will be based on. It is important to point out that the following picture does not compare the two markets to establish what has the greatest potential, but rather to establish the authors' view of the future development in the two markets. This is partly pointed out by illustrating the Latvian part of the picture smaller than China based on the extremely unevenness in size between the two markets, both in geographical but also in economic and politic aspects. No predictions will be made regarding the likelihood of S2 will occur simultaneously in China and Latvia, rather is it the authors presumptions of the most likely outcome, hence showed in the picture below as the shaded grey area. As stated before, the aim with the study is to find a solution of complementing the two markets in a sourcing perspective and not to compare the two markets with each other.

L A T V I A	S 3	A	D	G
	S 2	B	E	H
	S 1	C	F	I
		S 1	S 2	S 3
		C H I N A		

Scenario for Future development of China and Latvia

A – China is incurring an economic slow down which will pressure the governmental stability, social unrest and reduce governmental investments. This will enhance the ability of China as a low-cost producer as wage and factor costs will remain low, though, due the prevailing conditions within China, the uncertainties will increase as well as the exchange rate exposure to importers. The unstable situation in China demand complementary sourcing market to secure a stable products supply. Fast development in Latvia will provide a very limited future in regards to labour intensive sourcing, hence put pressure to quickly find other complimentary markets in Eastern Europe like

Ukraine, Russia, and Belarus. Still, one can expect Latvia to remain an exporter of more value added products higher up on the “product scale.”

B – A slow and unsecured development of China increases the importance of other complementary sourcing markets. A stable development in Latvia indicates good potential for sourcing activities on the Latvian market. As previously stated steady growth is incurred within the market, with both wage and factor cost increasing, though in conjunction with productivity. The transition towards a knowledge-based industry has begun and time limitations prevail regarding the future for Latvia as a complementary sourcing market in labour intensive production. Though as simple production will become to important in Latvia, they will still remain interesting in sourcing activities of higher value-added manufacturing as their relative cost are still far below Swedish standards.

C - If the developments in both markets are slow the unstable situation of China (quotas, SARS etc.) will lead to low prices but large uncertainties and must be combined with other sourcing market. The slow development of Latvia indicate a good future potential as labour and factor cost will remain low, hence competitive price levels on the Latvian market will prevail for a longer period of time. Even if Latvia is undergoing difficulties and slow growth, being a member of EU the regulatory framework is improved, hence reducing the uncertainties of the business environment.

D – As China is incurring stable growth while Latvia is growing fast and quickly rising on the industrialisation cycle, environmental scanning for new future complimentary sourcing markets is a must. China will remain an important market for sourcing as the labour intensive production will move westwards and more complex products can be purchased as they improve their production quality as well as R&D. Latvia on the other hand will rapidly become too expensive and only remain of interest for value added products higher up on the “product scale.”

E – Most likely combinational future development for both China and Latvia.

The grey zone surrounding the E box states the authors’ view of the most likely scenario regarding the future of the two markets in connection to each other. Many different scenarios are discussed in the text, however the “E-box”

represent the most likely outcome based upon it further analysis will be conducted in this thesis. Hence, no certainties will be dealt with as we are dealing with the future and many complex issues with uncertain outcomes must be taken into consideration.

The E scenario indicates a stable development in both countries. China is undergoing positive developments, both in regards to economic growth as well as political liberalisation. This will contribute to a stable sourcing environment and as relative wages will remain low, especially in the western region where most labour intensive production will be located, still complementary sourcing markets is of utmost importance. To secure stable and flexible product supply geographically closer situated markets has to be used. As Latvia is incurring stable and fairly high growth rates it will in the near coming future a good complementary sourcing market. As industry and productivity increases, labour intensive production as well as more value-added production can be sourced within. In the future, the emphasis on sourcing will be on value-added production and labour intensive will move further east, potentially into Ukraine, Belarus etc.

F – China is enjoying stable growth rates and labour and factor costs will rise in a predictable manner. As slow development is incurring in Latvia, this indicate a good future potential in using Latvia as a complementary sourcing market.

G – As both China and Latvia are enjoying fast growing economies and quickly rising on the industrialisation cycle, environmental scanning for new sourcing markets is a must. Fast development in China will not have any significant effects on sourcing in next coming generation due to the size of the market. Though, depending on how fast development China will undergo, the further westwards labour intensive production will be situation and the more value-added activities will be performed on the east side. It will take long time before companies need to find a new market for low cost production; nevertheless it is of utmost importance to continuously scan for new potential sourcing markets. As China's development is stable, working with complementary sourcing markets is prerequisite for success. Latvia on the other hand will rapidly become too expensive for retailers who want to import labour intensive products.

H – Fast development in the best-case scenario of China will still have to be combined with complementary sourcing markets with closer geographical location depending on product characteristics and consumer preferences. A stable development in Latvia indicates good potential for purchasing on the Latvian market, though, as steady growth is being incurred within the market, and transition towards a more knowledge based industry has began time limitations prevails regarding Latvia as a complementary sourcing market.

I – Rapid growth of China will further complicate sourcing as suppliers will be located further inland of the nation, but china will due to its vast population remain competitive. To secure stable and flexible product supply geographically closer situated markets has to be used. Slow development in Latvia indicates a good future potential in using Latvia as a complementary sourcing market.

The correlation between the two markets, presented in the nine-fielder above, has provided the focal standpoint for the authors to further analyse the sourcing activities and the supplier selection analysis within the retailing industry and the case of home textiles in ICA Non-Food. As stated before the aim with the scenario analysis was not to compare the two markets rather to indicate how both markets can be combined to reach an optimal solution for sourcing. The reason behind the selection of China and Latvia derived from the case study of home textiles but in other product groups other markets had probably been selected. The scenario analysis above has provided an understanding of what critical incident could incur in a future perspective in the investigated markets, which is of utmost importance to consider if sourcing activities will take place in researched markets. A short presentation of combinations of scenarios combined with recommendations of how to handle respective situation was presented and special attention was given to the most-likely scenario of both markets. Based on the empirical findings and the scenario analyses it is stated that the aspects of the most-likely scenarios will be applied to the case of home textiles and ICA Non-Food.