

## Dealing With A Chinese Manufacturer or A Chinese Import/Export Company?

By Frank Zhang

When you source products in China, an important decision you need to make is whether to deal with a Chinese manufacturer or a Chinese import/export company. Many foreign importers prefer a direct manufacturer because lower prices are expected. However, there are also disadvantages and risks in this approach. A thorough check on pros and cons helps to make the right decision.

### Access to Manufacturers

According to China's amended Foreign Trade Law promulgated on Apr. 06, 2004 and Measures on Registration of Foreign Trade Operators issued on Jun. 25, 2004, a local Chinese manufacturer can obtain import/export license by completing a simple registration procedure after Jul. 01, 2004. It is expected that foreign importers can directly access more Chinese manufacturers than before after the easing of restrictions.

However, a surge of applications for import/export licenses did not appear after the law took effect. Many Manufacturers still lack expertise in international trade and lack financial resources to develop international businesses. There is a long way to go for manufacturers to gain confidence. Therefore access to direct Chinese manufacturers is still limited.

Manufacturers in developed areas such as GuangDong Province, JiangSu Province, ZheJiang Province, ShangHai, Beijing and Tianjin are more experienced in international trade. Foreign importers have more chances to deal directly with manufacturers in these areas.

### Prices

Dealing directly with a manufacturer can reduce prices significantly. Usually a Chinese import/export company will have a markup of 5% to 20% on a manufacturer price

depending its overhead level and expected margin level. Some large import/export companies have surprisingly high overhead due to lax management and redundant organizations. Foreign importers can get considerable price reductions by dealing directly with a manufacturer.

Negotiating power is another important factor in price reductions. A local Chinese import/export company familiar with local market supply conditions can use many methods such as signing a long term contract, offering financial support and investing in a manufacturer to get preferential prices from a manufacturer. A foreign importer with less market information has less bargaining power and may not get a better price from a manufacturer than from an import/export company.

In some special cases, an import/export company may quote a price lower than a direct manufacturer in order to accomplish foreign exchange revenue task or win a new customer. Also a manufacturer may quote a price higher than an import/export company in order to maintain market prices.

There are many factors affect prices. Dealing directly with a manufacturer is not always a right strategy in cost reductions. Be open-minded and get more quotes from different sources is the best way to avoid mistakes.

### Quality and Schedule Control

Due to geographic distance and high cost involved, a foreign importer dealing directly with a manufacturer lack effective means to control quality and schedule. An import/export company close to a manufacturer can add value in this respect. It can visit the factory, conduct interim inspections and closely watch production progress. Some Chinese import/export

companies also use retention payment to control quality and schedule that is very effective and may not be adopted by a foreign importer.

### Payment Terms and Cash flow

In order to improve cash flow, many foreign importers especially large multinational corporations request 60 days or 90 days payment terms. Many Chinese manufacturers cannot accept such terms due to limited financial resources. Most of Chinese manufacturers are village and town enterprises that have no access to bank loans. Many private Chinese manufacturers run at zero bank loans! An import/export company may accept such terms if profits are relatively high. Import/export companies are usually state owned and can get financial support from local banks. Many import/export companies also have access to various export financing instruments such as packing loan, export bill purchase and export discounting.

In fact, many Chinese manufacturers prefer exporting through an import/export company because they can get fully paid promptly (including tax rebate) by import/export companies.

### Access to More Sources

An import/export company is usually not tied to one manufacturer. A foreign importer can get various products from an import/export company. Even for the same product an import/export company can also introduce different sources for an importer to choose. Dealing with an import/export company enable an importer to have access to more sources and reduce sourcing cost.

### Claims

As mentioned above, usually manufacturers have limited financial abilities and tight cash flows. When

claims on quality or delivery happen, a manufacturer may have not enough money to compensate and may ignore them. A foreign importer can probably make successful claims from an import/export company because they have enough money and will not risk their reputations. When dealing with a manufacturer, a foreign importer needs to conduct a thorough background check and never place orders beyond a manufacturer's abilities.

#### **Partnership Supplier Relations**

One popular theory in supply chain is cooperative supplier relations can reduce transaction cost and benefit both suppliers and customers. If a foreign importer's sourcing goal is to find a reliable and long-term source of products in China and adopt a

partnership relations approach, dealing directly with a manufacturer is absolutely the right strategy.

#### **Suggestions**

**Set up your own buying office in China.** With a buying office in China, a foreign importer can take advantages of dealing directly with manufacturers and reduce the risks.

**Set up your own trading company in China.** According to China's new laws, effective on Dec. 11, 2004, foreign invested trading companies are permitted. The minimum registered capital is only RMB500,000 (about USD61,000) and the setup procedures are not complicated. Be prepared to take the advantages of owning a trading company in China.

**Hire a local consulting company.** If you do not want to have a physical presence in China, it is a good idea to hire a local consulting company to help you in locating manufacturers, negotiating contract, controlling and conducting background check. Some experienced consultants can make a special arrangement between a manufacturer and an import/export company that reduce the trading company's markup to 1-3%.

Inherent price advantages exist to dealing with a direct Chinese manufacturer. Whether to adopt this approach also depends on what is available, what you are looking for and how to reduce the risks. Be open-minded and you can make a wise tradeoff decision.