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The Reversed China Phenomenon

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Abstract

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The objective of this thesis was to study the relocation of production back to Europe and the US from China. In order to be able to study this reversed phenomenon of production movement, concepts regarding internationalization and international production had to be researched. It was also essential to study China's economy and the China phenomenon, which signifies the original movement of production to China.

The research was implemented in the form of a desk study, using existing literature and publications. The theoretical framework consists of relevant theories of internationalization as well as the China phenomenon. Some sources were used for the study of the reversed phenomenon but this also left space for interpretations, and in the end conclusions were drawn by analysing the data available. Due to the phenomenon being current, news articles were found and used abundantly in addition to scientific releases and books. The theoretical framework proved to be sufficient and gave the author the necessary information to understand the reversed China phenomenon.

The results of this thesis answered the main research question which was "Why have companies moved production to China and why are they now coming back?".
The results proved the phenomenon to be a current event with many participants and with more to come. The results of this thesis are useful to companies that are involved in international production or that are contemplating the option. The study offers a vision on production relocation and also on the benefits and costs involved.

The significance between the location of production and the location of the target market proved to be essential. The big gap between China and other developing countries, proof of rising costs and also the number of companies already taking part in the reversed phenomenon turned out to be important findings.

Keywords
The China phenomenon, international production relocation, foreign direct investment, manufacturing costs

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1 Introduction

This research views the reasons why companies have moved their production to foreign countries and why some companies are now moving it back to the original venues. Production movement has mostly been targeted to lower-cost countries such as China and other parts of Asia. The main reason for this kind of plan of action is usually thought to be cost reductions, but this is just one of the reasons.

Production relocation has not proven to be the best solution for companies in the long run, and hence there is a new phenomenon of companies once again relocating their production - in reverse. Due to changes taking place in China, manufacturing costs are rising, and risks included in production relocation are beginning to be noticed.
The so-called back flow of production may well form new opportunities for companies to create new competitive advantages and to develop already existing knowledge and skills. The reversed phenomenon of production relocation is especially interesting from the perspective of companies whose competitive advantage lies in making high-quality products. The new movement of production has been taking place in Western countries in both the US and Europe. Reasons for the phenomenon of production movement has been researched and explained in this thesis on the behalf of China, Western Europe and the United States.

1.1 Thesis objectives

This thesis has been implemented in the form of a desk study. The objective is to find out reasons and explanations as to why companies that have once moved production to low-cost countries like China are now moving it back to Europe or the US. Defining the most significant internationalization theories and studying China as an economy will give answers to this research question.

The main research question is:

Why have companies moved production to China and why are they now coming back?

The sub-questions that answer the main question are:

1. **Why do companies move their production abroad?**
2. **Why do companies choose China as their production country?**
3. **Why are companies bringing their production back to Western countries?**

1.2 Thesis topic and scope

This thesis has been implemented in the form of a desk study. The thesis starts off by defining the most significant theories of internationalization from the manufacturing point of view. Foreign direct investment and offshore outsourcing are important components when studying production relocation, so they have been gathered under separate headings in chapter two before the main theories and explained in necessary detail in consideration of the scope of the thesis. The most significant theory is the one of multinational companies and the most distinguished source of explication to this by John H. Dunning. Other essential authors studied in the making of this thesis are Lundan, Griffin, Pustay and Andreff. The theoretical framework is situated at the end of chapter two, representing the scope of the thesis and to lightly sum up the theories.

In chapter three the paper then on continues to research on China. The chapter reviews China's economy, changes that have taken place during the last few years, how China's market works and most importantly the so-called China phenomenon (author's translation). Chapter four concentrates on the reversed China phenomenon (author's translation). This chapter examines the reversed phenomenon of the relocation of production to China and states reasons why companies return back home. The chapter ends with the author's conclusion. The thesis finishes off with chapter five, which is comprised of the discussion part.

This paper is examined on the behalf of China, Europe and the US. The China phenomenon has also been taking place, and continues to do so, in countries such as India and Bangladesh as well, but these have been left out of the review. A comprehensive package of various sources has been used in compiling this research together. These sources include books, news articles, and scientific research papers in Finnish as well as (mostly) English.

1.3 Concepts

The China phenomenon (author's translation) indicates the mass relocation of production to lower-cost countries in the search for lower production costs. The lower-cost countries are usually developing countries. (Kosonen, Kettunen & Heliste 2012, 8.)

International production relocation is "defined as the process of closing a manufacturing unit, or a part of production, in the home country followed by opening a plant abroad, in view of re-importing lower cost products in the national territory (or in view of continued delivery to export markets from this new plant abroad)" (Andreff 2009, 8-9).

Internationalization in the words of Welch and Luostarinen is "the process of increasing involvement in international operations" (Shi 2003, 359).

International production networks "involve producers operating in different countries or continents and different stages of production taking place in different countries" (Andreff 2009, 7). **Global production networks** are of the same basis but operate on a more comprehensive and strategically unified level (Andreff 2009, 12-14).

Lower-cost countries are usually developing countries that have a lower average wage per employee. Companies seek cost reductions as they expand operations to lower-cost countries (or low-cost countries) through lower wages and often also low-priced raw materials.

2 Internationalization theories

This section of the paper views theories of internationalization. The most typical reasons for a company wanting to become and internationally operating corporation are to expand business and market share, grow, and to become more profitable. Locating resources, finding new ideas and also cheaper workforce are major motivators for companies to extend operations abroad. A growing company can find the home market becoming too small for it, and wants to find low-cost employees in countries with lower labour costs in order to save in manufacturing expenses and hence start seeking opportunities in foreign countries.

There are many theories that relate to and explicate the relocation of production to foreign and especially low-cost countries. Here we will concentrate on the most comprehensive theories that state the reasons why companies choose to do this: the Uppsala model, the theory of multinational companies (MNCs) and the theory of born globals. The theory of MNCs in particular contains a number of branches, for instance marketing and HR, but this research focuses only on production. Here the theories are presented in the order of the basic and more traditional theories to the more radical approaches. First foreign direct investment and outsourcing are specified, because they are important concepts in all of the theories at hand.

2.1 Foreign direct investment

Foreign direct investment (FDI) is an important part of other internationalization theories, sometimes being the mean of how the company starts off its internationalization process in the first place. FDI means investing or transferring equity in order to create a subsidiary, merge, or create new facilities in a foreign country (Hannon & Reddy 2012). This sort of investment is not only about transferring equity or resources, but also includes the acquisition of control; the subsidiary, for instance, is part of the same organizational structure rather than just financially obligated to the parent company. (Krugman & Obstfeld 2009, 163.) This is also how FDI differs from foreign portfolio investment. FDI only consists of capital flows, whereas portfolio investments form a broader package, including assets such as management expertise for the firm. FDI is a form of investment where the firm intends to gain control over the decisions and assets of the firm it invests in. (Dunning & Lundan 2008, 7.) FDI forms a substantial part of total business investment in many countries. If foreign direct investment stands still, it can exacerbate the existing problems of a country and deepen an economic slowdown. (Hannon & Reddy 2012.) FDI has traditionally been the practice by which a company has achieved production expansion outside its own country. (Dunning & Lundan 2008, 7.)

Three different ways exist, through which FDI may be implemented. These consist of the greenfield strategy, the brownfield strategy or participating in a joint venture. The greenfield investment refers to the creation of something new. The company either rents or buys land, on which it builds new facilities and hires staff. Brownfield indicates an acquisition strategy. Here the company buys an already operating firm in the target country. The third alternative is a joint venture. Here two or more companies agree on collaboration and form a separate, jointly owned, firm in order to promote the mutual interests of all participants. Alternatives one and two together can also be referred to as mergers and acquisitions (M&A) (Griffin & Pustay 2010, 381-382).

FDI has increased tremendously in the last 30 years worldwide. FDI comes mostly from developed countries and mostly also goes to developed countries. (Griffin & Pustay 2010, 192-193.) Nevertheless, for the first time in history developing countries received half of all FDI flows in the first half of 2012, overtaking the US as the top destination of FDI in the world (Reuters 2012). There are numerous reasons why firms want to get involved with FDI. Ownership advantages in a foreign country such as economies of scale, brand name or superior technology, may help a company to integrate into the foreign market. Here ownership advantages are mostly referred to as competitive advantages. These enable firms to build factories and other facilities to countries where production is cheaper and hence manufacture goods under proprietary technology and a well-known brand at a much lower cost than before. (Griffin & Pustay 2010, 195.)

The popularity of FDI may partly be explained by the internalisation theory. An internalised subsidiary produces goods in a foreign country. This theory relies on the concept of transaction costs. Transaction costs occur when a firm tries to for example penetrate a new market through franchising or exporting. These costs are formed by negotiations, writing contracts and monitoring operations. The theory suggests that FDI is more likely to happen when the costs in question are high. The firm basically makes a decision between whether it is more profitable to own and manage its own factory in a foreign country or to create contracts with foreign companies in order to collaborate. (Griffin & Pustay 2010, 196.)

The third reason for FDI is the eclectic paradigm by John Dunning. This theory explains why one would take production to foreign countries in the first place. The theory in question combines ownership advantages, location advantages and internalisation advantages together in order to create a combined theory of FDI. Location theory denotes that the section of a company's business must be more profitable abroad in comparison to the local market. Moving closer towards locations of existing raw materials or cheaper labour can create location advantage. (Griffin & Pustay 2010, 196.) Internalisation explains why cross-border transactions are made hierarchal within a firm, i.e. increasing the efficiency of an MNC by making foreign market trade internalised, creating corporate international production, rather than being ascertained by market forces. (Dunning & Lundan 2008, 93-94; Shi 2003, 357.) According to Dunning, FDI happens when all formerly stated advantages occur (Griffin & Pustay 2010, 196).

Location advantages cover many aspects that help companies to make the decision of relocating production to a country like China. In order to furthermore point out what advantages can be formed through locational planning, below is a list created by Vereecke and Van Dierdonck (Colotla, Shi & Gregory 2003, 1190) stating some of these:

1) Proximity to suppliers
2) Availability of labour
3) Availability of skills and know-how
4) Proximity to market
5) Socio-political
6) Competition
7) Energy
8) Other

2.2 Offshore outsourcing

Outsourcing means acquiring goods or services from a third party, i.e. a firm outside the company itself. Companies tend to outsource functions that are not the most significant from its own perspective, so that the company itself can concentrate on more essential parts, such as strategic planning, and hence further develop its core competencies. Production and other processes, where specific know-how isn't necessarily required, can be transferred to a subcontractor. (Hoo Bae, Sik Yoo & Sarkis 2008, 2.) Outsourcing may signify outsourcing within the borders of a country, or internationally. Here we focus on international outsourcing, more commonly referred to as offshore outsourcing. Most frequently used ways for offshore outsourcing are outward FDI and international subcontracting. Offshore outsourcing can also be referred to as international production relocation. (Andreff 2009, 7-8.) In this thesis the use of the term production relocation nevertheless does not solely refer to outsourcing but instead to all kinds of production relocation.

Companies today are able to outsource anything from the service industry to the production industry. Here we focus on outsourcing production. The products made by subcontractors may well be either finished or semi-finished goods. The outsourced solution can be one specific part of the production process, where the company can finish off the products itself, or then a whole manufacturing unit can be relocated. In order for outsourcing to be considered a possibility, the production process must be possible to fragment. As companies get into offshore outsourcing they join the international production network. This is also called vertical specialisation, where parts of the process are fragmented into stages and then moved to various locations in different countries. Outsourcing can also occur through co-production agreements or international joint ventures (IJV) (Andreff 2009, 7-9.) Companies start considering outsourcing usually by the time the product life cycle matures and competition increases. This is when a firm needs to seek out ways it can enhance its efficiency; one way to do this is through cost reductions. (Hoo Bae et al. 2008, 2.)

Outsourcing has become a commonly used way of production implementation through globalization. Outsourcing gives the general impression that it creates cost reductions, through which it improves the profitability as well as the efficiency of the company. (Berggren 2005.) This is because production is most often moved to locations where costs are lowest and then the goods are re-imported back to the home country (or alternatively exported to another country). Nonetheless, labour and material costs cannot be the only reasons for outsourcing; efficiency levels must also be higher. (Andreff 2009, 7-9.) Even though these are the objectives and expectations, outsourcing is not always as cost-effective as the general impression tends to lead on. This is why companies need to take into consideration and find out all the possible benefits and drawbacks as well as perform a comprehensive risk analysis on matters that may occur through outsourcing. Production costs may well decrease due to low labour costs in developing and emerging countries. Logistics and customer relationships however may suffer in the process. (Berggren 2005.) This is because logistics, infrastructure and supply chains may not yet be as developed and reliable as in developed countries. Customer relationships may also suffer due to possible changes in the image of the company. Changes in product quality or having long product-delivery cycles that make the supply chain less responsive to changes in customer demand, are naturally seen as negative issues from the consumer's point of view. (Davidson 2010.)

2.3 The Uppsala internationalization model

The Uppsala internationalization model is a stage model. It is a traditional model that specifies a logical sequence of gradually gaining foreign market knowledge and entering successive markets abroad. By each stage in internationalizing, the firm learns and gains more experience while at the same time also increases resource commitment to each market in more depth. The difference between increasingly differing cultural and language attributes in foreign markets, in comparison to the home market, are referred to as "psychic distances" in literature. The psychic distance means that there are features that disturb or even prevent learning and understanding foreign markets. The more a country differs from the home country for example culturally, the longer the psychic distance. (Hollensen 2008, 54; Shi 2003, 357; Dunning & Lundan 2008, 91-92.) All in all, the two most important factors in this theory are knowledge and commitment (Shi 2003, 358).

The researchers discovered that before internationalization, firms operated in their domestic market for some time. When firms wanted to start operating more internationally, they tried entering nearby foreign markets through exporting. Gradually, the firm would start expanding towards more challenging markets. Only some years later, after exporting to the same market, would the company start to consider operating a fully, or even partly owned sales organization or manufacturing subsidiary in the foreign market. (Hollensen 2008, 56-57.)

Both general knowledge and market-specific knowledge are required when operating on an international level. Market-specific knowledge is gathered through experience, whereas general knowledge, or knowledge of operations, can be transferred from one country to another. Both are needed when moving to foreign markets, but the latter helps the firm beforehand and with geographic diversification, i.e. moving towards more diversified markets in relation to the domestic one. (Hollensen 2008, 56.)

Johanson and Wiedersheim-Paul and Johanson and Vahlne (Hollensen 2008, 56.; Shi 2003, 358) have distinguished four stages of internationalisation:

Stage 1: No regular export activities

Stage 2: Exporting through independent representatives (agents/export modes)

Stage 3: Establishment of a sales subsidiary in a foreign country

Stage 4: Foreign production or manufacturing units overseas

These stages are illustrated in figure 1. The figure shows how the company increases geographic diversification i.e. psychic difference as it expands operations to new markets. The horizontal part shows how market commitment increases through mode of operations i.e. the stages listed also above. At the same time as geographic diversification and market commitment increase, the company also becomes more international. This shows a direct relation between market commitment and knowledge (figure 1).

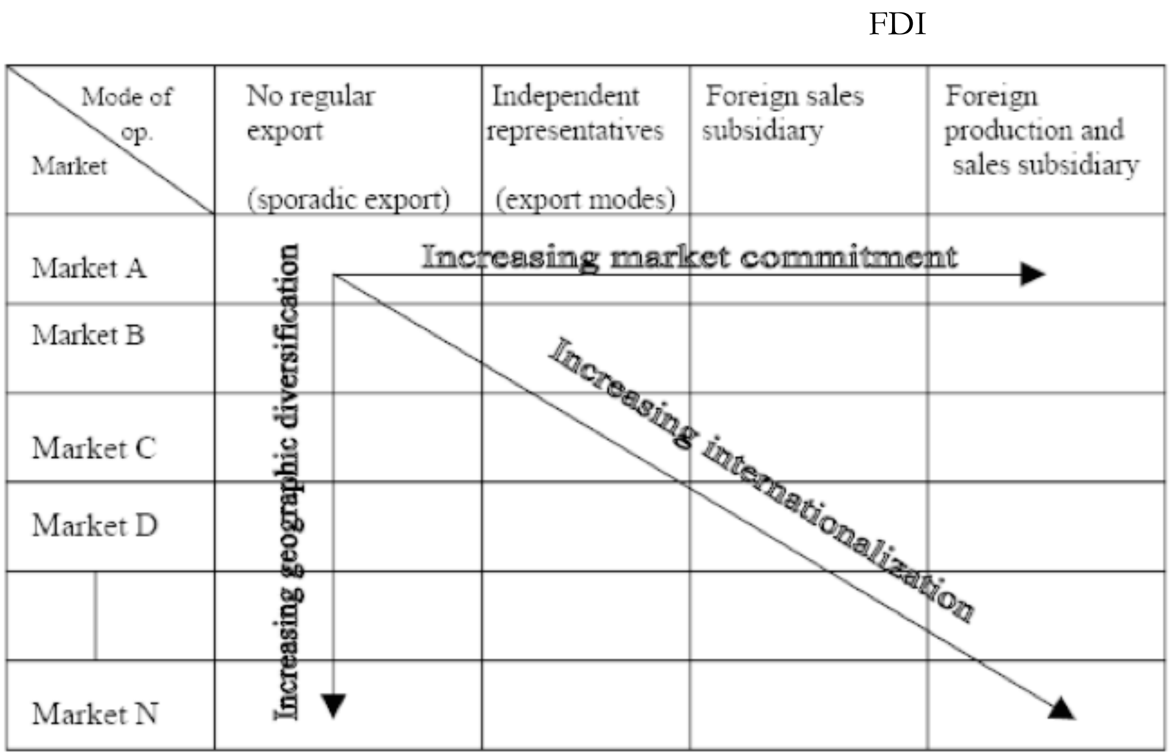


Figure 1. Internationalization of the firm: The Uppsala Model approach (Adapted from Forsgren and Johanson 1975, p.16) (Hollensen 2008, 57).

As was mentioned, the Uppsala model is a traditional way of entering foreign markets and not as commonly used as before. The following section on multinational corporations on the other hand is quite a big topic in today's business world.

2.4 The multinational company

The traditional strategy of the multinational company (MNC) began to form into a new, so-called global strategy in the 1980's, which links to the new globalisation era (Andreff 2009, 12). MNCs are thinking and acting in a more global sense, which indicates that MNCs operated in a somewhat dispersed manner before, possibly having quite independent affiliates. Now these companies are functioning in a more integrated and coordinated way, shaping their strategy into being more global instead of just international. The international system indicates having various localised strategies presenting a disconnected system. With the global strategy, the company should be able to make better and more efficient use of its internal potential globally, and also of its global resources within its reach. International and multinational companies differ from global companies, but sometimes these two get mixed up and used incorrectly in literature (figure 2). The global strategy aims at global rather than local optimisation, which means some subsidiaries for example may be let to operate in a less profitable way, if it means another subsidiary will be more profitable as an outcome. The global strategy of MNCs has been one immense factor of globalisation in general. The challenge for MNCs now is to gain strategic benefits from global manufacturing, after having invested in individual affiliates and plants for so long under the manner of a multi-domestic strategy. (Shi 2003, 357-359; Andreff 2009, 12-14.)

Figure 2. Illustration on the different strategy approaches (Svensson 2001, 15).

An MNC does not only indicate that it is a company operating in different countries. It is headquartered in one country i.e. the local country, and has operations, subsidiaries and other facilities in a number of other countries, but the definition of an MNC contains a much wider perspective in addition to all of this (Rugman & Collinson 2009, 39). There is no specific, defining moment or definition as to when a company becomes a multinational. MNCs are most often private businesses originated from developed countries, practice FDI, and either own or control activities in numerous locations (countries) that add value to the operations of the company. The largest MNCs can have over 200 foreign affiliates throughout the global market, making them global companies, while the smallest MNCs only have one or two. (Dunning & Lundan 2008, 54.) There are different ways how MNCs operate and distinctions referring to MNCs' ways of managing activities have been stated by for instance scholars and business analysts. One of these distinctions is presented below (figure 3).

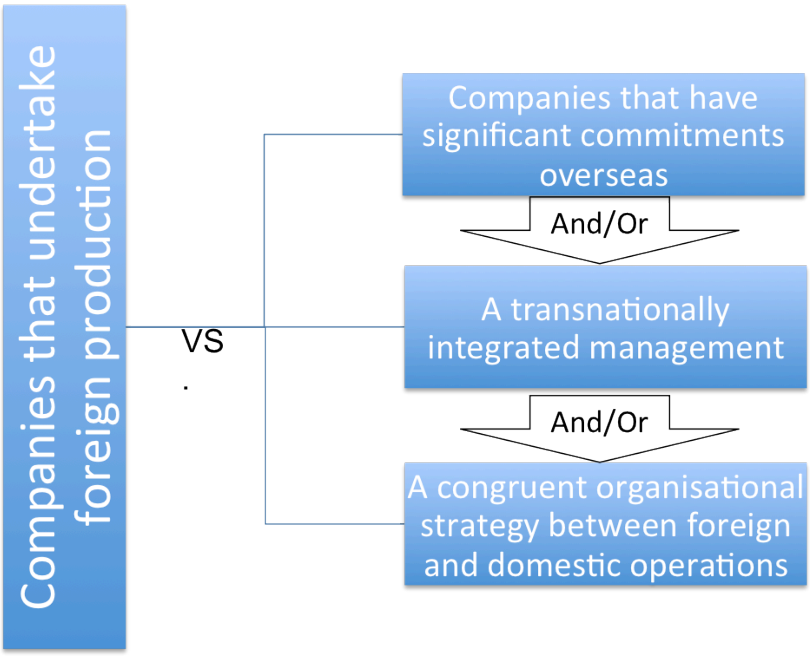
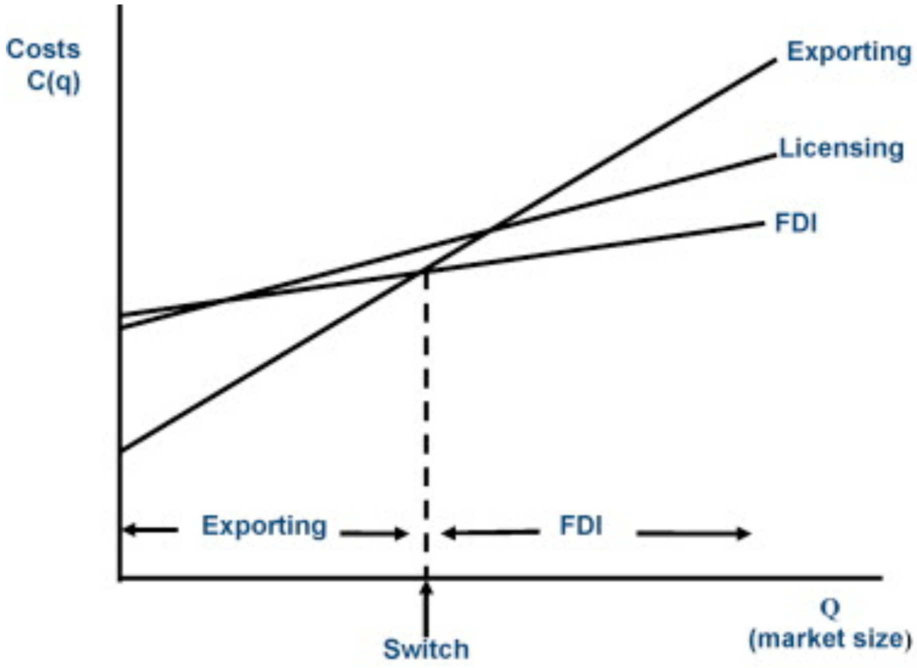


Figure 3. A distinction between the ways, that MNCs manage activities (Dunning & Lundan 2008, 3).

These distinctions (figure 3) help separate the MNCs that start off by acquiring and handling foreign manufacturing facilities, from those that really pursue a unified way of running the company by international collaboration – making it feel like one big global company (Dunning & Lundan 2008, 3-4).

Another common distinction is between whether the company manages multi-domestic foreign subsidiaries that operate independently, or whether the subsidiaries are part of a coordinated network. The former indicates each subsidiary mainly manufactures goods and services for the local market, and the latter that all affiliates are important in a wide network of creating and exploiting assets. (Dunning & Lundan 2008, 3.) This distinction can also be seen as the distinction between the traditional MNC strategy and the global MNC strategy – the global strategy meaning that the whole company operates as a seamless network.

As we mentioned earlier in chapter 2.2 on the section on outsourcing, in order for it to be possible to scatter different stages of production worldwide, the production process must be possible to fragment. Even though the production process may be extremely fragmented and complex, MNCs attempt to keep in control over the production chain in order to preserve know-how and proprietary technology. Global MNCs strive for adjustments in global and local demand. This can be done through handling the processes of flexible or lean production (creating as much value as possible). International production can consist of offshore outsourcing, FDI and international subcontracting. All of these ways are used by MNCs, FDI and outsourcing being the most common. Differences in wages are usually big motivators for MNCs to consider outsourcing. Some stages of production are therefore moved to low-cost countries, where specifically unit labour costs are lower: lower wages alone aren't sufficient i.e. efficiency and productivity also need to be higher. (Andreff 2009, 7-15.) FDI and setting up a fully owned subsidiary abroad is usually the final stage of internationalization. The process of internationalization might proceed in the order of licensing, exporting with an agent or distributor, exporting through own sales representative or sales subsidiary, local packaging and/or assembly facilities and finally FDI. (Rugman & Collinson 2009, 42.) Due to the existing volatility in the global economy, it has become increasingly important for MNCs to operate in a more flexible manner. As the market size increases, it becomes all the more profitable for an MNC to engage in FDI. (Figure 4.)



N.B. In this example, licensing is never the preferred alternative
Reproduced from Buckley and Casson (1981) p 80.

Figure 4. The timing of FDI (Buckley 2012, 44-45).

MNCs seem to have the tendency, or more so the possession of power, to make national boundaries seem superfluous. An MNC functions within its own set of rules and can sometimes seem indifferent towards national boundaries and ways of operating. Also this makes it hard to identify the home country of an MNC. Company names can be so international and also they're way of operating so complex, that it can be nearly impossible to target them to one specific country of origin. As MNCs operate in different parts of the world, they have to take certain factors into account. These environmental forces include competitors, customers, suppliers, financial institutions and also the government. This brings out the challenge of MNCs to be able to balance global integration with local responsiveness. (Rugman & Collinson 2009, 41; Shi 2003, 359.)

The United Nation has identified over 60 000 MNCs worldwide. The largest 500 of these MNCs account for as much as 80 % of the world's FDI. Most of the largest MNCs come from the Triad. The Triad countries consist of the United States, Europe and Japan. This takes us to the conclusion, that in order to analyse the MNC strategy, one ought to focus on the triad. (Rugman & Collinson 2009, 40.) The Quad countries on the other hand consist of the Triad countries plus Canada. The Quad countries have been said to be extremely important from the perspective of MNCs. Some believe that an MNC will not succeed in the global economy if it does not have a strong presence in various parts of the Quad. (Financial Accounting and Management, 2010.)

The main form of foreign involvement for MNCs is FDI (Dunning & Lundan 2008, 7.) Reasons for wanting to become a multinational company are various. For example foreign competition, protection of domestic market share and reduced costs (long-term profitability) are a few examples. (Rugman & Collinson 2009, 45.) MNCs have a lot of power operating in global markets, but expanding a company over numerous countries also brings many challenges along with it. An affiliate may have differing views as how to manage the business and conflicts of interest between stakeholders in different countries may occur. (Dunning & Lundan 2008, 64.)

MNCs also gather together a so-called pool of resources, which includes elements such as patents, assets, trademarks, and human resources. Affiliates of an MNC are all part of the same company basically, and are thus allowed to use assets that are usually prohibited from outsiders. Also if affiliates are in need of a loan, financial institutions will be more amenable when the loan will be backed by an MNC. An MNC links all affiliates and business partners so that they all share a common strategic vision. (Rugman & Collinson 2009, 41.)

MNCs are usually attracted to countries with large populations and high per capita income. MNCs nowadays are also attracted to China. China does not have a high per capita GDP, but it has a massive population and a growing economy, which makes it a very interesting field for MNCs. (Rugman & Collinson 2009, 42.)

Dunning (Andreff 2009, 12; Dunning & Lundan 2008, 67-68) has based his MNC strategy view around four main types of activity:

1. resource seekers
2. market seekers
3. efficiency seekers
4. asset seekers

Large MNCs pursue multiple objectives most engaging in FDI that combines two or more of the activities in the list above. The approaching strategy of an MNC can be defined as either defensive or aggressive, depending on the company taking either a proactive approach in order to advance strategic objectives or a reactive approach to actions already taken by its competitors. As the MNC matures as a foreign investor, motives for foreign production also change. As the company starts internationalising, it would most likely start with activities one and two, and along with the maturing process, maybe move onto stages three and four. (Dunning & Lundan 2008, 68.) Efficiency and asset seeking can be associated with the process of globalisation. The global strategy of MNCs links all these strategies together in addition to offshore outsourcing. This strategy frees MNCs from national territories and also weakens efficiency of state interventions. (Andreff 2009, 13-14.)

Resource seeking mainly implies MNCs seeking natural resources. Companies seek resources that are of higher quality with lower costs than what is available at the original location - if available at all. This way the company becomes more profitable and competitive in markets it operates in, or is planning to operate in. Usually goods acquired are exported to developed countries. Resources sought can be either physical resources, labour or skills-oriented resources. Physical resources include goods such as metals or agricultural products, labour resources include well-motivated unskilled or skilled employees, and skills imply expertise such as technological know-how. As labour costs rose in many countries along with economic growth, China became one of the biggest target countries for resource seeking investments. (Dunning & Lundan 2008, 68-69.)

Market seeking investment signifies companies that invest in one place in order to supply goods and services to that place, or venues close by, i.e. open an access to a foreign market (Andreff 2009, 12). Most importantly, when serving a market from a relatively close distance, production and transaction costs are lower than supplying from further away. Also as more of a statement, it may be seen as an important gesture to have a physical presence in some of the markets served by competitors. Sometimes the host government might impose tariffs or other similar costs making exports more costly and thus directly or indirectly encouraging market-oriented investments. In some cases taxation is reduced in order to attract inward investments from foreign companies. (Dunning & Lundan 2008, 69-71.) Close to the market seeking strategy is horizontal FDI, where similar manufacturing units are replicated to foreign countries in order to widen the access to a market abroad (Andreff 2009, 13).

Efficiency seeking is about making sense of the structures of resource-based or market-seeking investments so that the company can gain as much as it can from them. Efficiency can be sought after through economies of scale and scope and risk diversification. Here the company strives to use the skills, relative cost and availability of resources as well as it can. (Dunning & Lundan 2008, 72.) In short, this means MNCs organise operations on a global scale, having subsidiaries in different locations doing different things, usually in countries where labour costs are low. Sometimes due to this strategy MNCs might close down facilities in the home country. Efficiency seekers' objectives can also be met by international subcontracting in offshore outsourcing. Just as horizontal FDI is regarded similar to the market seeking strategy, vertical FDI is close to efficiency seeking. Vertical FDI vertically divides labour into different stages and production facilities within an MNC in search of savings in manufacturing costs due to international differences in wages. (Andreff 2009, 12-13.)

The strategic asset seeking MNCs aim to strengthen their assembly of physical assets and workforce capabilities globally, i.e. the assets that will help the company expand, be more productive and competitive in the global market. The long-term objective is to become globally more competitive thorough acquiring assets from foreign companies (through FDI). Strategic asset seeking can happen through e.g. alliances, mergers with foreign competitors, or buying a firm out in order to be able to offer a larger range of products. In other words, this is the only strategy that cannot rely on international sub-contracting or greenfield investment. (Dunning & Lundan 2008, 72-73; Andreff 2009, 13.)

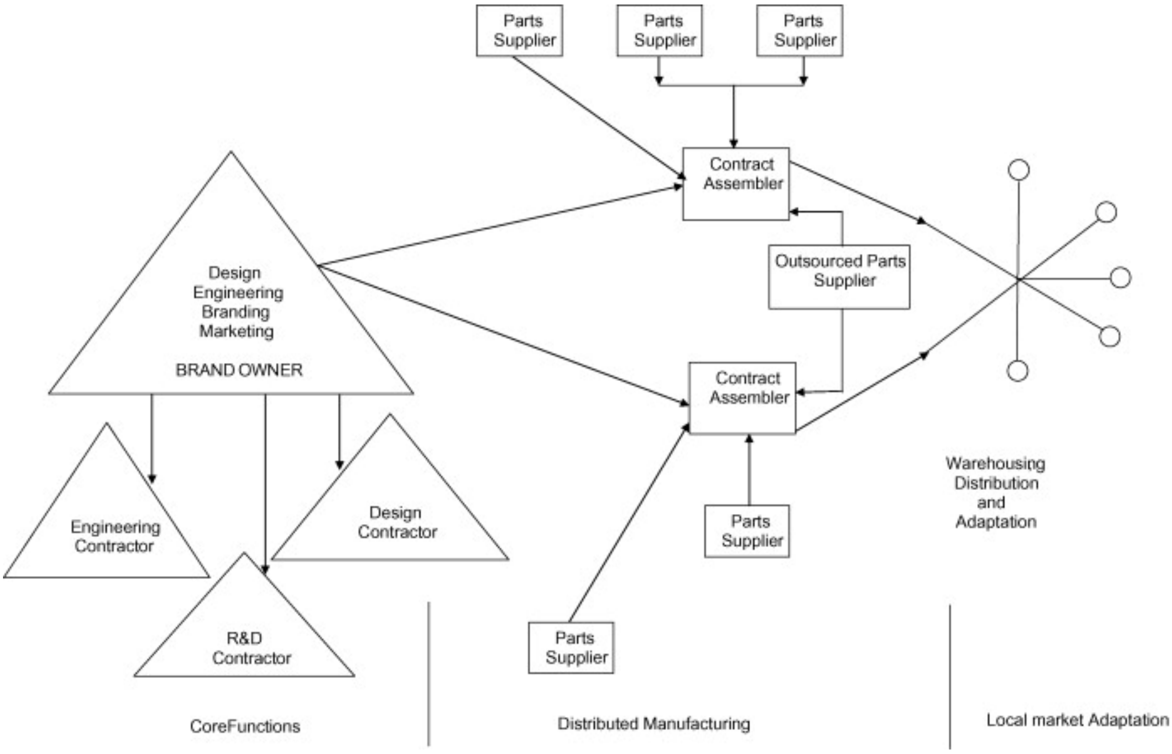


Figure 5. Globally distributed operations (Buckley 2012, 48).

The new global strategy on MNCs transforms the vertically integrated company into a global factory (figure 5). The global factory suggests somewhat dramatic changes in the MNCs location and ownership strategies. The more complex networks within the company raises the question of how to control all of these activities and where each of them should be located. This easily blindsides the MNC from the national restrictions and soon the company operates within as well as outside of them. The global factory consists of both vertical and horizontal networks. This offers the company a flexible structure, which helps in becoming more resilient and facilitates absorbing shocks. (Buckley 2012, 44-51.)

As globally operating MNCs function in global oligopolies, competition is also on "world level". Price lowering doesn't occur, but instead these companies rely on global product standardisation and differentiation, global marketing and technological innovations. Adjustments and reactions to international changes are instant, but adjustments are smaller than that of local firms, e.g. MNCs don't lay off people often, but when they do, it happens instantly. (Andreff 2009, 15.) In a nutshell, global strategy as a term indicates a focus on similarities, homogenization, concentration, and coordination worldwide (Svensson 2001, 8).

2.5 Born global

The model of born global differs greatly from the other internationalisation models introduced in this paper. Other models start off with the concept that firms internationalise gradually, first operating in the domestic market. The theory of born globals seems to challenge the more traditional internationalisation models. A company that is referred to as a born global, means that the company in question has aimed at international or global markets right from its inception (figure 6), without any long-term internationalisation or domestic period beforehand. (Hollensen 2008, 63.)

The key factors in operating a company like this are available infrastructure, IT and communication skills all put together by a skilled workforce. This combination of attributes makes it possible for a born global firm to operate in a manner where location and timing doesn't matter in the same way as it usually does for companies. The born global operates in a "here and now" trade and information exchange all over the world, reducing geographical processes. (Hollensen 2008, 63.)

Born globals are rarely big companies looking to expand their range of operations. They're usually SMEs with less than 500 employees and tend to be managed by entrepreneurial visionaries who view the world as one big, interactive and integrated marketplace. They depend on the newest technologies available and are innovative companies. (Hollensen 2008, 63-64.)

The born global model and the Uppsala model can be seen as opposites, from the viewpoint of internationalisation theories. The Uppsala model is a relatively slow and individual way of going global, whereas the born global model needs connections, co-operation and partnerships in order to grow and internationalise quickly. (Hollensen 2008, 64-65.)

Unlike firms operating according to models similar to the Uppsala one, born globals don't have the time to develop skills by combining and studying past experiences in entering foreign markets. They need to possess these skills beforehand or alternatively learn them while doing, i.e. collaborating with firms who already have the required skills. (Hollensen 2008, 65.)

As was mentioned before, born globals are usually SMEs and hence cannot take a multi-domestic approach like large companies. This is because smaller companies don't have sufficient scale to operate worldwide. Most often the chosen business field of a born global is more or less homogenous and requires minimal adaption to the marketing mix (product, price, place & promotion). (Hollensen 2008, 65.) This is how the born global –model also differs from the MNC strategy. Other than being very internationalised or globalised companies, they don't have that much in common. MNCs are huge companies that expand their international territories gradually through e.g. FDI, while born globals don't have these stages (figure 6). Also born globals are immensely dependent upon technology in order to be able to do business, often lacking the actual facilities in different countries and locations.

Because of the born global feature of being a rather small, innovative company, it needs to commercialize in lead markets first. This is due to born globals often having high R&D costs from the very beginning and lead markets are high-growth potential markets, usually providing a quick way to access other markets for innovation-rich firms. Competition is usually intense for these companies and they are vulnerable because of their dependence on their niche market. (Hollensen 2008, 65.)

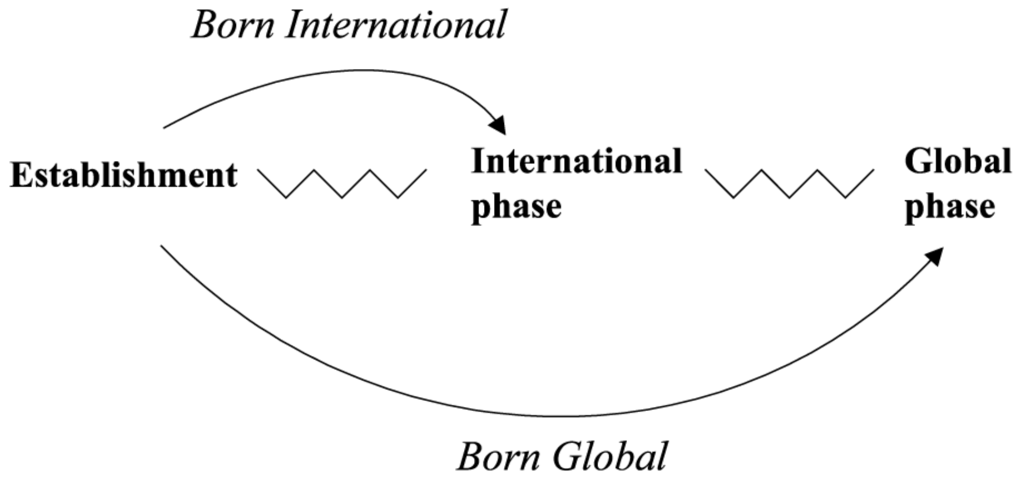


Figure 6. A born global (Gabrielsson, Sasi & Darling 2004).

2.6 Interaction between the theories

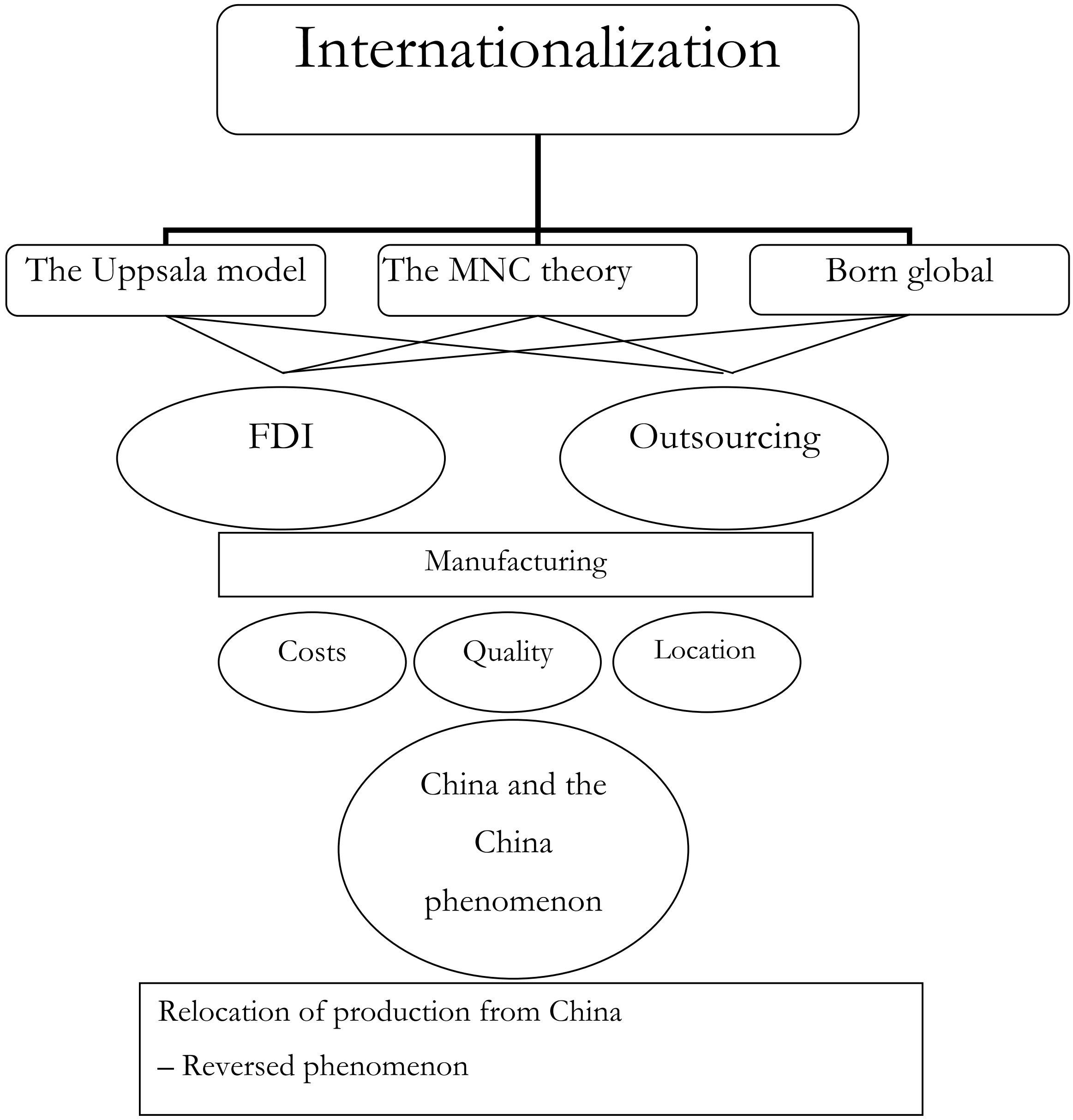


Figure 7. Theoretical framework

The theoretical framework first combines the Uppsala model, MNC theory and born global as theories of internationalization. These theories explain internationalization processes of firms and their ways of operating across national boundaries. Foreign direct investment and outsourcing are pertinent in each theory mentioned and thus connected to all theories in the illustration (figure 7). What this thesis concentrates on is the relocation of production and so manufacturing has been located right next underneath these. What companies seem to consider important issues among manufacturing are product quality, manufacturing costs and the location of production and other operations (related to transportation of goods).

After going through the internationalization theories, the research moves on to viewing China and the so-called China phenomenon, which indicates production relocation to low-cost countries such as China. From this the subject moves on to the China phenomenon being reversed, i.e. companies moving production back to Europe.

3 China

This thesis has been implemented in the form of a desk study. The research is hence built upon already existing information available in print or published on the Internet. This information is then used and conclusions are made by analysing the data available.

This section closer examines China, the relocation of production to China specifically, and the causes and effects of this phenomenon. China is one of the world's most powerful countries, close to the USA and Europe, and actually the world's largest manufacturer. It is a huge country geographic and population wise, with over 1.3 billion people. The country has undergone many changes in the last few decades, freeing trade, becoming an open market economy and lifting people from poverty to name a few. China's demographics are changing rapidly and consumers' demands are increasing as their income rises. (Hedley, 1; The Economist 2012.)

These changes have granted China the status it has in the world market today. Many believe that cheap labour and production are the mere reasons for companies to move their production abroad. This of course plays a big role in the decision-making, however in addition to this, there is a lot more to take into consideration.

3.1 China's rise

The annual GDP growth of China during the 21st century has been phenomenal; it has been over 8 % and in the beginning of the century it soared to a two-digit rate. The growth has somewhat decreased, but still exceeds 7 %. The GDP growth of 2012 was 7,8 % and the objective for the current year is 7,5 %. Even though growth has somewhat diminished, it is still significantly higher than that of developed countries. It can be pointed out that the GDP of Western countries roughly vary around 2 percent. (Eskola 2013.)

Numerous foreign companies have landed into China during the years. Foreign companies have invested in China in order to bring their production to China, or merely in order to expand their clientele. FDI for example exploded in China in 1992 and since then China has been a popular target country for outward FDI for many foreign companies (figure 8). (Griffin & Pustay 2010, 64.)

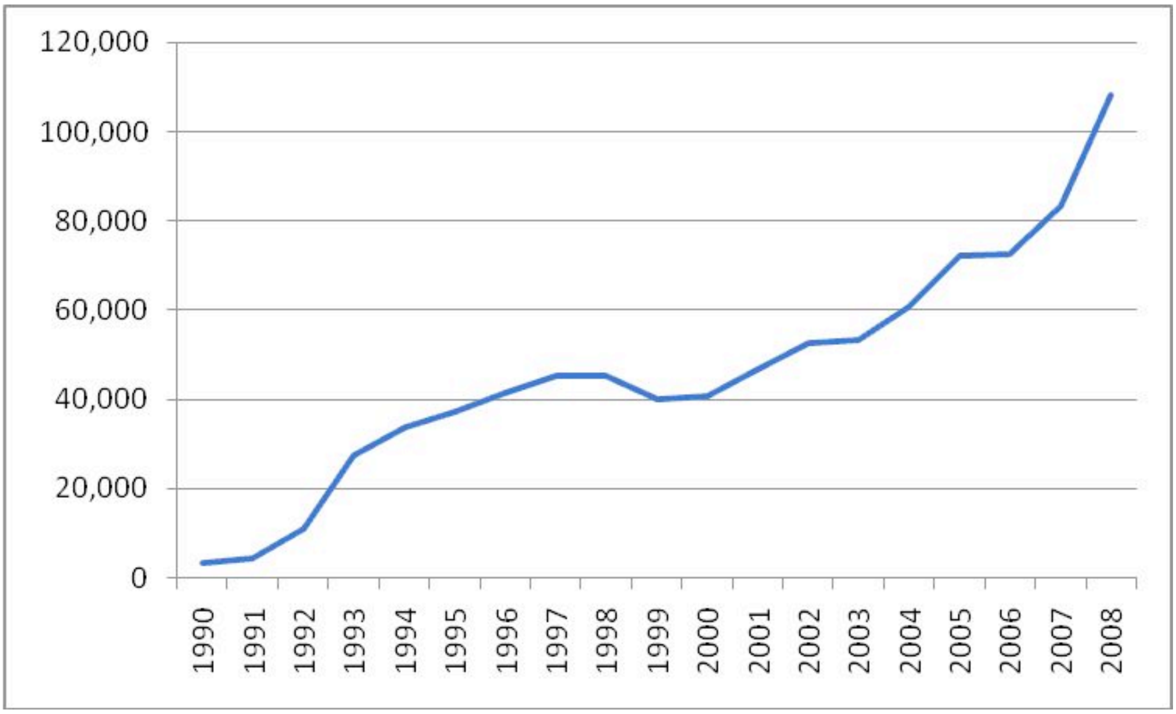


Figure 8. China's annual flow of inward FDI from 1990 to 2008 (millions of USD) (Choo & Anderson 2011).

FDI from China's perspective is very fascinating. China is one of the world's largest targets for FDI. China competes with the USA for the first place in being the largest target country of FDI. In the beginning of the 21st century China was still leading the statistics, but since 2003 the US has bypassed China as the most desirable candidate for FDI. (Hannon & Reddy 2012.) In the statement by Reuters though, according to the United Nations Conference on Trade and Development (UNCTAD) China went past the USA for the first time in many years in the first half of 2012 (Reuters 2012). When comparing GDP, China is still a greater FDI target country than the USA in terms of percentages (OECD 2012, 5).

Facts mentioned in the paragraph above are some major factors in the growth of China, but the biggest reason is the economic reform of China in 1978, breaking down the centrally planned communist state and gradually opening up China's market to the world through the establishment of an open market economy (Asikainen & Vuori

2005, 28; Rugman & Collinson 2009, 617). Another breaking point in freeing China's trade to the world was its entry to the World Trade Organization (WTO) in 2001 (Hedley, 5). With the help of freeing trade, exports, imports as well as FDI surged in China (Rugman & Collinson 2009, 617-618). From 1978, the export volume was roughly $9.8 billion, whereas in 2004 it was $593.4 billion (figure 9). This is over 60 times the export volume before the reformation of China's economy. (Zhang 2006, 1.) Major exports for China are for example apparel, textiles, electrical machinery and also petroleum products (Rugman & Collinson 2009, 617-618).

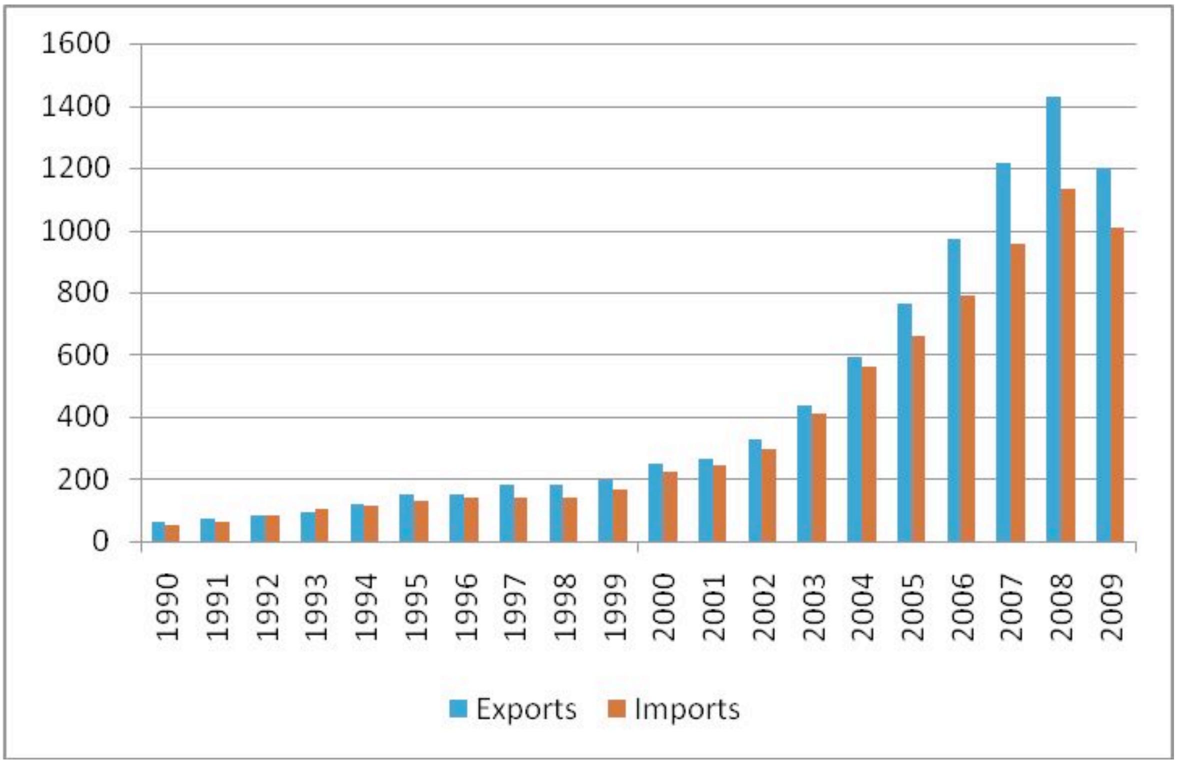


Figure 9. External trade growth of China from 1990 to 2009 (billions of USD) (Choo & Anderson 2011).

China is the world's largest producer of wheat, rice, cotton, tobacco, red meat, coal and aluminum. China manufactures approximately 70 % of the world's toys, 60 % of all bicycles and 40 % of all mobile phones and large amounts of other products such as televisions and steel pipes. (Rugman & Collinson 2009, 617; The Economist 2012.) Around 70 % of all FDI flows come from manufacturing industries. Also R&D investments are currently on the rise in China. (Rugman & Collinson 2009, 623-624.)

China is the largest host of MNC affiliates compared to all other economies. Mostly investments come in the form of M&A's and wholly foreign-owned enterprises (WFOE's). Even though China's growth has been fast, investments have mainly been concentrated in industrialized areas in the east and other urban areas. This means, that even though many people have been raised above the poverty level, many places hold large amounts of people still struggling with poverty. (Rugman & Collinson 2009, 623.)

China has developed and grown so much, that it not only receives FDI, but has also become a significant outward foreign direct investor itself (figure 10). China has for example undertaken resource-seeking investments in Africa, West Asia and Latin America in the mining and petroleum industries. (Dunning and Lundan 2008, 26-28.) These investments are not only conducted by large firms such as MNCs but also smaller firms are involved in outward FDI. The Chinese government encourages this by supporting the efforts of smaller firms to seek new markets and resources in foreign countries. (Dunning and Lundan 2008, 29.)

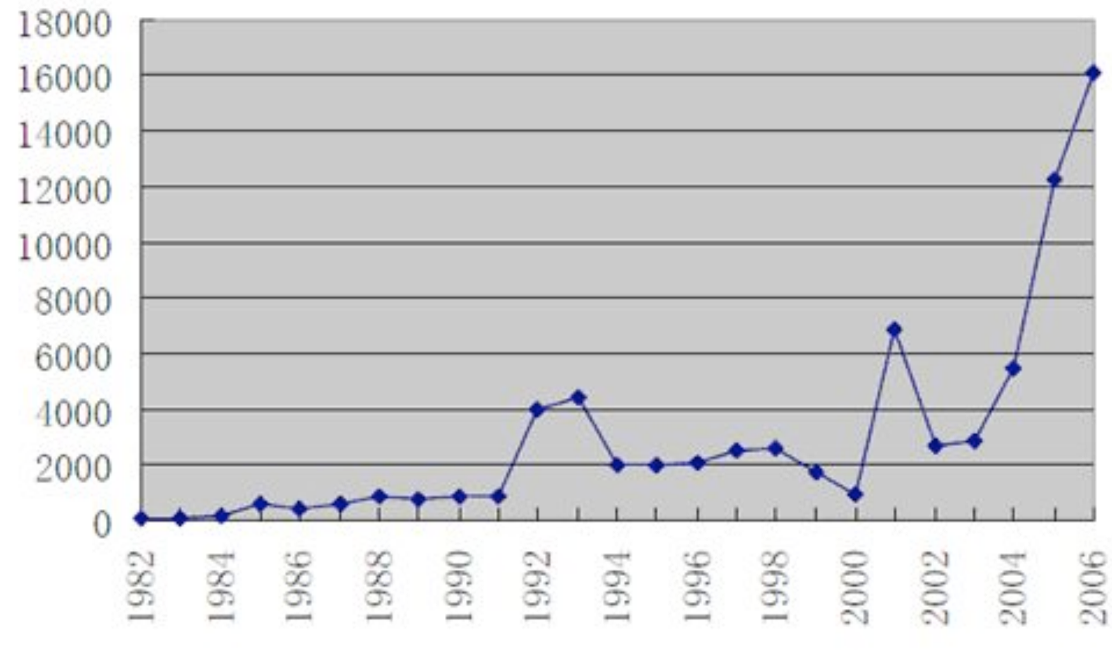


Figure 10. China's outward FDI flow from 1982 to 2006 (millions of USD) (Choo & Anderson 2011).

3.2 Entering the China market

Entering the China market differs from usual market penetration strategies. China is culturally very different from Western countries and its market extremely heterogeneous. Already the size and scale of the country alone present many challenges for foreign companies (Hedley, 1). The business environment in China is volatile and unpredictable and foreign companies may often underestimate the challenges of entering it. Preceding any decision to enter the Chinese market, acquiring and analysing data is essential. Foreign companies operating in China have had mixed experiences; some companies have flourished and made incredible profits, others have not been as lucky. Before a company makes a decision on entering the China market, it should consider its resources, prior experience in exporting, past market-entry experiences and do a lot of research on China. (ChinaInvest 2011, 2-3.)

Investigating the China market thoroughly before planning to enter it is crucial. The economy of China is still centrally planned to some extent. This can have an effect on market penetration plans and strategies of foreign firms. Rights are still influenced by central, regional and local government agencies. (Rugman & Collinson 2009, 626-627.) What also needs to be kept in mind is that China is a country that values traditions. When conducting business with the Chinese, visiting the country and doing business face to face is the best way to proceed. Long-term business relationships are valued, so choosing business partners and maintaining the relationships require a lot of time and effort. (ChinaInvest 2011, 3.) One must study (operational) working habits, evaluate risks clearly, set firm product standards, decide on the geographical location of expansion and also have everything important in the contract (especially on behalf of protecting intellectual property, e.g. trademarks). Depending on the type of business, it is essential to know the best places in China, where the type of business could most easily flourish. Foreign companies involved in consumer markets have most often located their operations to coastal provinces. Production of for example textiles, apparel and toys has mostly been situated in coastal cities like Guangzhou and Zhejiang. (Hedley, 2.) One can talk about China's Tier 1 and Tier 2 cities. Tier 1 includes cities that have been most popular for foreign companies, due to these cities having the most matured markets, making them the least risky to enter. The downside is that operational costs and competition are high. China's Tier 2 cities include those under economic growth and rising incomes. Set-up costs, operational costs and also competition in these regions are lower than in Tier 1 cities. The rising incomes of consumers in these cities are creating rapid growth in demand for foreign products, which in turn creates opportunities for foreign firms. Foreign companies that wish to create local manufacturing facilities in China need to take many matters into consideration. These include the infrastructure of local manufacturing and logistics, raw materials, availability of labour, local regulations and the locations of suppliers and customers. (Hedley, 4).

One big annoyance for big companies existing in China is piracy. Even though a firm would have comprehensive international property rights (IPR), domestic firms in China still conduct piracy, and they can be difficult to catch. This is largely due to the lack of Chinese government protection regarding property rights. (ChinaInvest 2011, 3.) The fact that China has a "first-to-file" patent system can sometimes end up treating companies in an unfair manner. This first-to-file system indicates, that whoever registers a patent becomes the beholder, even though this company wouldn't necessarily be the inventor. Even a legitimate brand or logo can be used in China by a domestic firm, if it has not been registered as a trademark by the China Trademark Office. (Hedley, 8-9.)

Making a decision about moving production to countries like China is justified for a number of reasons. These reasons include e.g. low labour costs and workforce availability, availability of skills and know-how, competition, and lower energy costs (Colotla, Shi & Gregory, 2003). For entering the China market, FDI modes such as listed below (Rugman & Collinson 2009, 626-627) have been used:

1) Joint shareholding corporations
2) (Contractual) cooperative businesses
3) Wholly foreign-owned enterprises (WFOE's)
4) Joint development/exploitation/production companies
5) Foreign-funded shareholding companies

3.3 The China phenomenon

One could say that the China phenomenon (author's translation) gradually started already in the 1970's but sore in the 90's and beginning of the new millennium. The China phenomenon indicates the movement of production to low-cost countries, in order to improve efficiency and reduce manufacturing costs. (Kauppalehti 2012.) Other benefits are also possible tax reliefs. Critics of the China phenomenon believe that companies have moved production units to China in order to avoid strict collective and safety regulations as well as environmental legislation. (Kosonen et al. 2012, 10.) This sort of production relocation has been done by all kinds of companies, mostly MNCs, and the production has been outsourced or alternatively the company has invested in its own facilities abroad through FDI. The China phenomenon has helped China's economy grow, given jobs to the Chinese and increased their know-how.

If relocation of production could take place in any low-cost or developing country, why did it begin in China? There is cheap labour in Africa as well, but this kind of phenomenon has not taken place there – at least not nearly to this extent. One enormous reason is the know-how of the Chinese and their incredible motivation and speed for learning and development. (Rugman & Collinson 2009, 623.) Another reason is also the population. China has the biggest population in the world, and numerous amounts of poor people searching for jobs. Also China's supply chain is well developed and relatively dependable. (The Economist 2012.)

The attractiveness of China to companies can be affirmed just by studying the volume of FDI inflows to China (figure 8). China is on the top of the list of countries receiving most FDI. (Hannon & Reddy 2012.) Even so, cost advantages are still the strongest reason for a foreign company to want to invest in China (Rugman & Collinson 2009, 621).

Foreign companies outsourcing production to China has also significantly increased. Outsourcing augments immensely to the Chinese industrial value added (nearly one fifth) and value added by foreign firms in China (over 60 %). Assembling and manufacturing components and semi-finished goods from foreign companies added up to more than half of Chinese overall exports in 2005, 80 % of which were achieved by foreign MNCs' affiliates based in China. (Andreff 2009, 11.)

Positive issues of outsourcing to China are matters such as cheap labour, lower capital costs, low-cost product design and R&D and also large manufacturing capacities (Rugman & Collinson 2009, 621). These issues are positive from the perspective of the outsourcing company, not necessarily the workers or China's development. The average price level in China is lower than in Europe, but there have been incidents where Chinese employees have not been paid enough to even cover basic living expenses. Employees have even committed suicide due to poor working conditions. (China Labor Watch 2010.) In 2008 around 600-700 million Chinese were living below the poverty level (Xi & Li 2010). This along with strikes and the increasing amounts of manufacturing jobs have led to an increase in wages and other costs related to manufacturing in China. This however results in products becoming more expensive and many other changes, which will be further discussed in the next chapter.

Some might say that the production relocation to China and its manufacturing quantities in general would result in China becoming a world factory. It is believed that China would become the second largest exporter in the world (now being third) and that its share of world exports would exceed 10 %. (Zhang 2006, 1.) Nonetheless, the growing quantities of production complicate and deepen the already existing environmental problems in China.

In today's world, China is not the same as it used to be. China has risen up to the level of one of the most powerful and productive countries in the world, close to the USA and Europe. China's annual GDP growth is phenomenal, at times it has even reached two digit numbers in percentages. This impacts manufacturing costs in an increasing manner. The corruption of officials, environmental problems and economic restructuring are still challenges for the country to this day. The leaders of China must continue working on the restructure of China in order to diminish the dependence on polluting smokestack industries. In order to meet this objective, advanced industries and domestic demand must increase. (Paakkanen 2013.) Due to these changes in China, many foreign companies have started do doubt the benefits of their presence in China. This goes especially for companies who have sought after lower production costs. Some feel as though they should move production back to the original venue and some companies have already done this. This takes us to the subject of the China phenomenon being reversed.

4 The reversed China phenomenon

There has been a shift in the way firms view relocating production to China. The shift is towards a more critical point of view, and many firms now believe, that the benefits may not necessarily outweigh the costs and risks. Relocating production back to the original venues (i.e. back to Western countries) has started to take place. Companies are more careful about moving production to China, or keeping it there, due to new knowledge gained through experiences. (Kosonen et al. 2012, 8.) This is called the reversed China-phenomenon (author's translation).

The reversed phenomenon takes place in both North America as well as Europe. Many experts believe that the phenomenon in question will only intensify in the near future. Production movement to China primarily started because of low labour costs and lighter taxation policies. Today, labour costs as well as other production costs in China are rising faster than in Western countries, especially around the coastal and Eastern areas of China. This means, that in most cases the cost-efficiency is not as good as it used to be, even though efficiency has also risen in China. Provinces in China's coastal and Eastern areas face increasing competition between employers and the availability and cost of energy. (Seppälä 2011.)

It has been stated, that China has exceeded the so-called Lewis' turning point, where the supply of labour decreases and the cost of labour increases. When the amount of lower-wage workers decreases, the economy has to develop. If the workforce were to migrate to central-China, this would create logistical and infrastructural challenges. The reversed China-phenomenon may well in the future be seen within the product sector of high-quality products, where quality and reliability on delivery are more important than pricing. (Seppälä 2011; Ranta 2011.) This chapter considers the reasons why foreign companies take part in the reversed China phenomenon.

4.1 Changes and effects

As was stated in the previous chapter, China's economy has grown tremendously, raising the country to the top among other trade and economic powers. Due to China's economic growth though, China wishes that foreign companies would support the re-structure of the country. This means, that investments directed at high technology, R&D, energy and environmental industries are supported, instead of investments directed towards traditional manufacturing industries. Also business regulations towards foreign companies have become stricter, which may complicate entering the China market. (Ministry for Foreign Affairs of Finland 2013.) Environmental legislation is now more stringent and before granting permission for local production, foreign companies are demanded to go through environmental assessments (Hedley, 5). Most companies wanting to engage in outward FDI to China in the present, are companies that want to invest because of the growing consumption and demand in China's domestic market, not so much due to lower manufacturing costs. China is a growing market place and this is what foreign companies operating in China should be interested in. China is trying to decrease its dependence on trade and strengthen its economic growth by domestic demand. (Taloussanomat 2011.)

China has been growing its trade so much that there has been surplus trade between China and the US. As a result, the US has been planning to limit China's exports to the country. The EU has also been planning to limit imports regarding for example apparel industries because of the threat towards local manufacturers in Europe. (Rugman & Collinson 2009, 626.)

Order quantities demanded by Chinese manufacturers are often enormous in order to lower unit production costs. This can cause problems for many companies that produce their goods in China. Problems can occur because of the sheer volumes or as quality defects. When large quantities of goods are manufactured as mass production, it can be more likely that product defects occur. Problems due to the volume of produced goods may appear if it is more than the firm actually needs and is able to sell. Larger quantities of ready-made products can be obtained with the same amount of money as smaller volumes. This is a tempting offer for companies, but the downside is that the benefits gained from this "more with less" mentality may lead to additional costs due to inventory and possible destruction costs of unsold goods. Especially for industries that produce by volume it may be more sensible to operate geographically closer to the end customers than all the way in China. This can be helpful among industries that use automated processes in order to provide cost efficiency. In a case like this, labour costs would not necessarily rise even though wages in Europe are higher, because workforce would not be as needed due to automation. (Ranta 2011.)

As companies first started outsourcing their production to low-cost countries, the primary objective was naturally to lower related costs. Later on, issues concerning product quality and product safety in Chinese production have emerged. Customers are more aware of how companies function than before; corporate transparency is respected and more or less demanded by customers. Quality and safety are regarded more important among many products and product lines in comparison to cheap prices. The quality of products produced in China can be qualified as deficient and long distances along with a number of middlemen are likely to cause uncertainties with deliveries. Mistakes made at the manufacturing level can end up costing the company a lot. If a company wishes to conduct quality inspections, this also adds to the product costs. Also the geographically created gap between product development and production and trying to get the whole chain to operate under the same principles are problematic issues. Companies are not eager to fly hours on end to China for business trips. (Ranta 2011; Davidson 2010.) Supply chains are transforming into more complex arrangements due to internationalization and globalization.

The fact nonetheless is that costs are rising faster in China in comparison to Western countries. These costs include wages, environmental and safety regulations based costs, energy, taxes and costs related to owning land or other property. Costs are rising especially around coastal areas, where most factories are situated. (The Economist 2012.) Minimum wages are regularly increased. There is already a big demand for skilled as well as un-skilled workforce in China, and the demand will only rise as China's One-Child Policy catches up with the country. The amount of available labour is predicted to comparatively decrease already by the year 2015. This will result in yet increasing demand for labour, more competition and higher salaries. Another fact is that China wants to increase demand on its domestic markets and decrease dependability on trade. The crisis in Europe has only strengthened this policy. In order for domestic consumption to bloom, people need to have more money to spend and thus salaries need to be raised. (ILO Newsroom 2012.)

Labour costs in China are rising as much as 10 %- 20 % on average annually. This has been said to being to biggest challenge at the moment for foreign companies in China – corruption and piracy being left behind in comparison. A veteran industrialist Joerg Wuttke with the EU Chamber of Commerce in China has predicted costs of manufacturing continuing to increase and even double by the year 2020. This sort of increase creates a big change in the cost structure of foreign companies situated in China. A consultancy AlixPartners also offers a vision that if the currency and shipping costs in China annually rise by 5 % and wages by 30 %, that by 2015 it ought to cost just the same to manufacture products in Northern countries as it would to manufacture them in China and then transport them. These figures are may turn out to be extravagant, but it shows the trend that the situation is moving towards. (The Economist 2012.)

As was mentioned, wages are not the only costs rising: energy costs, raw materials and the cost of oil are also increasing. Increasing oil costs make transportation costs higher. (Remes 2011.) Also the long distance between Europe and China, as well as the US and China, adds to the price that end customer will pay, because long distances add up to even higher transportation costs.

The growing cost of raw materials in China is one thing, but many MNCs actually export some of their own raw materials to China. Chinese workers then assemble these together. One benefit of moving production to China is moving closer to the source of raw materials and obtaining them at a lower price than in Western countries. But a company first exporting materials to China and then re-importing them back adds to the final costs. (Asikainen & Vuori 2005, 45.)

Products becoming more expensive might be acceptable to Chinese consumers with increasing demand for quality products - if they can afford them. Westerners on the other hand do not necessarily want to pay more for products they consider to be mostly of poor quality or almost the same price as cheap goods manufactured in Europe.

Higher wages add up to higher manufacturing costs that in the end will show up as increasing prices the end customer will pay.

Europe and other developed countries are still the main market places for many Finnish and other European companies. For these companies, fast entry into the Asian market is not the main objective; hence manufacturing in Europe ought to be competitive in many aspects. Locational advantages include logistical reliefs, good availability of energy, investment incentives by the state that can create competitive advantage, and also fairly low levels of macroeconomic risks. (Seppälä 2011.) Copyright infringements in China also still prevail to this day. Comprehensive protection towards industrial copyrights and patents are essential when conducting business in China. (Ministry for Foreign Affairs of Finland 2013.)

The vast economic growth of China has also lead to serious environmental problems. These environmental issues create health problems as well as problems concerning the safety of products manufactured in China. The economic growth of the country has been put in front of everything else and hence the overwhelming quantities of manufacturing have had their impacts on the environment. Exhausts involving for example logistics and production could actually grow 50-70 % by the year 2020. Lakes have been contaminated in addition to increasing amounts of air pollution, and heavy metals have been found in the ground. (Saraste, 2013.) China is the world's largest energy consumer and will still rely on fossil fuels for many years to come in order to sustain economic growth, even though the use of renewable forms of energy use is on the rise. (Ministry for Foreign Affairs of Finland 2013.)

Chapter 2.4 considered the aspect of global MNCs not making decisions based on differences between countries. This concept is not quite unambiguous. Factories around the world cannot all be treated in an equal manner because rules, laws and cultural behaviour between countries differ. Also consumer behaviour differs a whole lot from country to country. In the case of many products made by MNCs, it is misleading to state a product being "made in China" or "made in Bangladesh" - "world made" is a concept that fits better. Production processes and supply chains are so fragmented and complex that even the companies don't always know where certain raw materials come from or where a certain component was assembled. It has become nearly impossible to locate the national origins of a given product in today's diverse world. (Andreff 2009, 17.) This cannot be considered a positive thing to any extent. Many scandals concerning origins of products could be avoided if companies kept supply chains and other operations simpler. One good example of this is the topic concerning convenience foods and them not containing foods they are supposed to (e.g. horsemeat being sold as beef to consumers) (BBC news 2013).

There are positive as well as negative aspects in MNC globalising. Yip (Svensson 2001, 9) has listed some of these. Positive aspects mentioned were cost reductions, improved quality of products and programs, enhanced customer preference and increased competitive leverage. Negative issues mentioned were reduction of responsiveness to local needs, distance activities from the customer, increased currency risk, reduction of adaption to local customer behaviour and the local marketing environment and local competitiveness. (Svensson 2001, 9.) The statement concerning improved product quality is debatable and much more so dependable on production location – this may or may not be meant as production being situated in China or a lower-cost country.

Negative aspects on outsourcing have also been recognised after it has been tried. These issues are such as listed below (Rugman & Collinson 2009, 621):

- Communication problems
- Low product quality
- Long initial start-up times
- Intellectual property theft
- Increased management complexity
- Operational and supply chain changes

Communication problems arise because of language differences and communication and coordination costs arise because of the physical distance between production and company management (Andreff 2009, 7). Companies are to be extremely cautious regarding quality issues when outsourcing or otherwise moving production to low-cost countries and seeking cost efficiency. There have been various occasions and cases where the products manufactured in China have been of poor quality and in the worst-case scenario, even dangerous. When outsourcing production, firms need to lay down accurate and realistic contracts regarding quality standards and quality control. (Hoo Bae et al. 2008, 5.) The quality and safety standards of products are notably stricter in Europe and the US than in Asia. This is something to be taken into account and implementation of product safety must be monitored. Cases where product safety regulations have been violated are for example lead-painted toys manufactured in China, animal foods containing melamine and also toothpastes spoiled by diethylene glycol. (Hoo Bae et al. 2008, 5.) Contracts must state what sort of products or product lines and deliveries it involves, and also clearly list the responsibilities and obligations of all parties involved.

Some companies have also considered the opportunity to move production inland, where costs are not expectedly as high as in coastal and urban areas. But this is misleading because moving inland can create unexpected costs and some infrastructural and logistical challenges. (Seppälä 2011.) Some inland areas can belong to the Tier 2 cities hence there is definitely demand for foreign products, but the economic growth and rise in incomes also means other costs might increase rapidly. Also new laws in well-developed and wealthy cities such as Shenzhen have made it harder and more expensive to shut down factories in those places. Also transportation costs from inland to the coast can cost more than shipments from Shanghai to New York. Again, the reason why foreign companies would move to inland areas is to serve the local consumers within these rising cities. It would not necessarily be too profitable to move there for the sake of production costs and export goods. (The Economist 2012.)

A researcher for Statistics Finland called Elisa Riihimäki, has pointed out that outsourcing is a long-term strategic decision (Seretin 2009). In the long run, a company must take various risks into account. The firm might become needlessly dependent on its subcontractors, it might not able to make use of all its R&D know-how as efficiently, or the subcontractors could end up copying the firm's proprietary technology to its own account (Hoo Bae et al. 2008, 18). In many cases developing the firm's own production can turn out to be a more viable alternative. Through this sort of development a company can achieve enormous reductions in production costs. This way the company is also saved from possible disadvantages caused by outsourcing. Through improving internal production it is possible to create flexibility and more customer-specific solutions. Both of these outcomes are excellent derivatives for increasing customer satisfaction and trust (in the firm). Increasing efficiency is a core factor for a company to maintain its competitive advantage and developing the use of investments helps maintain it. (Berggren 2005.) Next we will go through some examples of companies who have not achieved the desired outcomes or have otherwise failed in production relocation.

Siemens

Berggren writes about Siemens as an example of a company that was disappointed by outsourcing. Siemens investigated its cost structure and experiences post outsourcing, waiting to find improvements such as fewer investments made, lower total costs and faster market penetration of new products. The results shown after three years did not quite exceed Siemens' expectations. Investments did decrease, but the interaction between the firm's development and production no longer existed, procurement prices did not get any lower and the profit gained from lower wages by the subcontractor fell short because of product transportation costs and the profit margin of the subcontractor. (Berggren 2005.)

Foxconn

Foxconn has been manufacturing products in China for Apple. Presently this company is making more investments outside of China as well. In addition to countries such as Brazil and Indonesia, it is looking into expanding manufacturing to the USA, because customers (i.e. Apple) wish more of the manufacturing process would be done there. (Chang 2013.)

Nike

Nike is a so-called hollow corporation. Nike does not own any manufacturing facilities anymore since they have all been outsourced to foreign subcontractors in Asia. Pakistan, Indonesia and China are the low-cost countries where the production of Nike's products takes place. As an outcome, Nike has been accused of child labour and pitiful wages. Nike has held all accountability on its subcontractors. Since the 1990's the situation has improved slightly. (Andreff 2009, 18.) As MNCs outsource operations, they lose control over them and their responsibility.

Helkama Velox Ltd.

This example shows the relocation of production back to Europe from Asia. The production has not occurred in China, but it backs up the theory of the reversed phenomenon as a general and very real factor. The research institute of the Finnish economy released a discussion paper in 2012 concerning the value chain of a Finnish designed bicycle and its production being moved back to Europe from Asia. The research states how the value chain of product manufacturing has been split up into many parts and how value is gained through each step – it concentrates on the idea of selling value with the product. The biggest reason why Helkama decided to rethink their Asian production was the supply chain. The supply chain did not operate in the expected way i.e. it was too slow in regard to consumer demand fluctuations. Quality control was not as good and delivery times where long. The components were also shipped to Asia for assembling the bicycles, which caused extra costs for the company. As has been stated in this thesis, one reason for relocating production to China should be the availability of (cheaper) raw materials. As a conclusion the research on Helkama states that it is more profitable for the company to manufacture bicycles in the Baltics rather than in Asia. The main advantages of moving production closer to the Baltics are lower wages than in many other parts of Europe, more agile logistics for deliveries due to shorter distances between the Baltics and Finland and also fixed exchange rates. The whole production of the famous bicycle jopo has been brought back to Hanko, Finland. (Helkama Velox Oy 2010; Kalm & Seppälä 2012.)

Companies such as General Electric, Sauder, Wham-O, NCR, Caterpillar, Dell, Lappset and Coach have each made the decision to move (a part) their production elsewhere from China (Seppälä 2011; Davidson 2010; The Economist 2011; Ranta 2011).

Functionalities of supply chains are complex and there is always a risk. When companies decide to engage in outsourcing, similar problems might occur as with the original supply chain of the company. In addition to these problems however, it appears to be more difficult to resolve these issues when operations have been outsourced to another party. This is due to longer distances causing long product-delivery cycles and also the possible language and culture divide. Reduced costs are often the expected outcome of outsourcing and this is usually because companies agree to a single long-run production slot**.** The problem is usually the fact that the slot is not flexible. Ordering quantity or timing changes are difficult to arrange. When product quantities are under-ordered the additional run costs more and in the case of over-ordering, larger inventory facilities are needed. Also in the case of over-ordering and sales objectives not being met, clearing unnecessary stock and discounting creates profit reductions. Decisions concerning outsourced operations have to be made early on. These include decisions on fabrics, colours and design. In addition to these so-called judgemental risks, there are also physical and environmental risks regarding supply chains i.e. earthquakes, hurricanes etc. (Waters 2007, 206.)

Political risks are also risks regarding supply chains, but these are not always taken into account as strongly as they should be. Political risks include (poor) working conditions of factory employees in comparison to similar jobs in Europe, EU trade quotas and even China's quarrels with Japan. These issues may well affect companies' ability to trade and also put a stain on a brand image. (Waters 2007, 208; Chang 2013.)

January 2013 has been said to being the worst month in four years, regarding FDI inflows to China. China attracted $ 9,3 billion in January, which is 7,3 % less than in January 2012. Also the FDI of the whole year 2012 was less than it was in 2011. FDI can be considered as an instrument in measuring foreign confidence in Chinese production. By the outlook of FDI flows right now, it seems like businesses are having second thoughts about manufacturing in China. (Chang 2013.)

4.2 Conclusion

When a foreign company manufacturing in China makes the decision to relocate the production elsewhere, managers contemplate whether to move production to yet another lower-cost country, e.g. Vietnam, or back to the original location. The reasons why many decide not to try another low-cost country are the lack of reliable suppliers, lack of a reliable supply chain, fewer efficient workers and the lasting issue of long distances. As a general rule, it can be stated that companies usually consider competence to be more important than costs. (The Economist 2012.)

As was stated earlier in this study, competitiveness in manufacturing industries cannot be measured solely by comparing labour costs – effectiveness of employees and entire supply chains need to be compared. Even though supply chains in China are fairly advanced and dependable, long distances all the way to Europe or the US still add big risks, thus making them somewhat unreliable. (The Economist 2012.) In the case of a natural disaster for example, supplies and deliveries could get completely cut off for some time.

The biggest matter that should affect the decision of relocating production away from China is the geographical distance between production and distribution. This physical distance complicates operations within the firm. In the case of a company having its target market in the West while costs are rising in China, it would be sensible to move production back since for example locational advantages (Dunning's eclectic paradigm) no longer occur (Griffin and Pustay 2010, 196). It is more environmentally friendly as well as locally responsible, for companies to support domestic economies. If all manufacturing were to move to lower-cost countries, it would create many problems for Western economies. These problems would be related to matters such as taxation policies and jobs. Innovation has also been found to flourish easier when research and manufacturing processes are physically close to each other (The Economist 2013).

Relocating production has its risks and benefits. The world market today is big and comprehensive with tighter competition between companies than ever before. From this aspect it is understandable that companies want to try and reduce costs any way they can in order to stay competitive. The point however is that this concept does not make a company viable in the long run. Risks in outsourcing manufacturing include intellectual thefts, loss of control and in many cases reduction of product quality. Production relocation to China by internalising i.e. FDI, manufacturing products by forming subsidiaries abroad, still creates challenges for companies due to long distances, exchange rate risks and increasing production costs.

All the risks mentioned above create costs for companies. Too many items produced and not all of them getting sold creates costs. If too few products are manufactured, the chain from China to Europe or America might not be flexible or fast enough to react to consumer needs, or then the obligatory extra production slot is relatively more expensive than a regular one. On-time delivery is very important, late deliveries due to long distances create costs and might include a loss of customer loyalty or trust – which in the end will prove to be an enormous loss for the company. Product defects caused by poor quality create costs. Shipping creates costs. With all these risks, companies should realise, that the relative cost of having production in China is almost the same as the production cost at a local facility in a Western economy – and will soon be the same.

The reversed phenomenon is a good thing for companies that manufacture products of high quality. For these companies, cost is not the issue and with quality they are able to gain competitive advantage in the Western markets. Also it can help build new opportunities for Western companies if they were to start concentrating on developing their knowledge and skills instead of outsourcing.

Consumers today are demanding and in the know. Of course there is also a divide between consumers who want the cheapest product available and others who value the product quality. In developed countries such as Finland, the orientation seems to be towards the latter. Newspapers are filled with articles about working conditions in developing countries and sweat shops, local and environmental responsibility as well as the adversities caused by local production being moved elsewhere. It would be a locally responsive deed, to bring production back closer to the end customer, not to mention more environmentally friendly. Long distances in transportation between China and Europe, or China and the US, creates additional pollution.

China's coastal manufacturing oasis is close to becoming a kind of world factory. China is so polluted that many believe it cannot handle more growth. China has to either slow down or innovate (The Economist 2012). In order for China to be able to do this, FDI should be aimed at R&D and service industries rather than manufacturing. China cannot continue manufacturing at the pace that it has during the past few decades, otherwise it might not survive in the long run. China has developed enormously and now it is time for developed countries to give China the chance to improve. The power of global companies constrains developing countries by creating jobs in labour intensive production and in the end it is challenging for the developing economy to rise above this.

The conclusion of this thesis is not that globalisation is a bad concept. Globalisation has opened up the world, but this does not mean that MNCs and other large international and global companies should continue to grow and become more powerful along with it. The international market place needs competition as much as any other. If competition becomes scarce due to an MNC being too competitive, the companies gain too much power. The power may not only appear as financial power but is also already seen happening when for example examining the indifference of MNCs towards national differences. Many differences can be found in cultural and managerial ways between countries. Globalisation does not mean all countries should become similar. By emphasising the importance of local, or even nearby manufacturing, it enables countries to continue producing products unique to each one and keeping their value. The cultural differences on top of the time difference between the Western countries and China create many challenges. This can be seen as a different or slower way of carrying out operations in China in comparison to the way the parent company meant for them to be done, for example when R&D is in a different country than production.

Misunderstandings are easily realized when people from differing cultural backgrounds interact. Also the time difference makes communication even more complicated.

Jobs that are highly labour intensive will continue to stay in many parts of China (Davidson 2010). If foreign companies operating in China are there in order to bring products to the Chinese market, it is beneficial to stay. The emphasis of this conclusion is strongly based on location. Where the distribution is, the production should be. Productivity in China is rising, so even though costs rise, it does not necessarily mean that producing for the local market is any less profitable.

Supply chains in the international market are complex. Simplifying the supply chain will simplify the value chain and the company as well as consumers will be more certain about the origin of each product and hence feel more secure about any given item. Jobs that require high levels of competence and/or automation are sure to be successful in Europe and America (Remes 2011).

To sum up, companies are now starting to realise they overdid their production relocation to China, trusted the concept too easily and are now discovering hidden costs caused by this. It helps a company to have R&D and manufacturing close together in order to implement innovations easier and control the quality more meticulously. What also should decide the location of production is the location of the target market and customers. If the target customers are in China, it then makes sense to manufacture the products in China. But, if the customers are located in Europe or the US all the quality, cost, shipping and communication issues secure the conclusion that the manufacturing would be best done in Europe or the US.

The process of production relocation will not be a fast one. The China phenomenon will still continue to live on to some extent, but the survey conducted by the Boston Consulting Group in spring 2012 where almost two-fifths of firms confirmed that they had been considering or already planning to move manufacturing processes back the US, supports the change in how companies view the phenomenon (The Economist 2013). Many are sure this number of companies coming back will only increase during the years to come. Companies will start the process of coming back home little by little, moving parts of the process back and more later on – which is also how they should have acted with the original movement of production relocation to China.

5 Discussion

The study of the reversed China phenomenon is a current topic. Many are not yet aware of the phenomenon but it is becoming more established through news articles and as more companies accompany the backflow of production, it will become a more known subject than it is at the moment. This section of the paper reviews key findings, the validity and reliability of the study, further research recommendations and also some reflcetions of the author.

5.1 Key findings

The key results of this thesis consist of

1. the increasing production costs in China
2. the number of companies that have already started leaving China
3. the difference that production location makes
4. the wide gap between China and other developing countries

The increasing labour costs in China was one of the corner stones on which the thesis was built on. The finding of related production costs rising in addition added certainty to the fact that it is becoming more expensive to manufacture goods in China related to the situation just a few years back. Also the amount of companies considering the movement back to Europe or the US was more than had been expected. As the reversed phenomenon is a relatively new subject, two-fifths of companies situated in China confirming their consideration of moving production back is a big proportion (The Economist 2013).

The difference that production location makes is an intriguing find. According to the findings, the physical distance created by production relocation overseas complicates the compatibility of innovation to manufacturing processes and the implementation of this. Researchers believe that production and development should be geographically close together in order to maximise the success of trying out new innovations. The results and feedback are available to both the manufacturing party as well as the R&D department in a more seamless manner when they are not geographically far apart.

This is especially valid in this case due to the cultural differences between the countries where R&D is located and where manufacturing is located. Cultural differences and also the time difference add additional challenges.

The fourth key finding regarding the gap between the development process between China and other emerging or developing countries is also essential. The effectiveness of China's workforce, the speed by which it has developed and built reliable supply chains within the country is uncanny. This is an important explanation as to why companies will most likely not move production to other low-cost countries in case they decide to leave China. Customers value quality and felixibility, and these are most likely acquired when movement of production back the Western economies takes place.

5.2 Validity and reliability

The aim of a research is to provide reliable results. That is why each study is to have an evaluation of the validity and reliability of the research. The validity of a research may be tainted by the author's own perceptions or interpretations of a given subject. (Yli-Kerälä 2011.) In the form of a desk study it is crucial to have various sources that support the author's vision and results. The sources are to be of different kind i.e. books, articles, scientific releases etc. in order for the author to be able to prove the validity. It is important that the similar results or indications of these are found in the sources. The fact that the author does not have an empirical part to interpret makes the validity somewhat stronger because it does not leave too much room for false interpretations. Results are based on facts found in existing literature and publications on the Internet.

This thesis answers the research question. The research question was "Why have companies moved production to China and why are they now coming back?". Theories related to and giving ground for the relocation of production have been studied and introduced thoroughly in relation to the required depth of the study. These conribute to the validity of the thesis and also finding sources supporting the view of the reversed China phenomenon add to this. The sources used in this thesis consist of current news articles, scientific releases from the 21st century as well as books containing theories of internationalization that have been established years ago and are still more than valid. The results found in this study may be generalised in the context it has been presented in.

Reliability indicates that if the study were to be done again, the same results should be acquired. Results are to be consistent and not randomly found. (Yli-Kerälä 2011.) The reliability of a desk study can be determined by what conclusions other researchers come to when studying the data used. Sources back up the results of this thesis.

5.3 Further research

This thesis will help companies, large or small, to see the advantages and risks of outsourcing and FDI in production relocation to lower-cost countries. From this thesis they will understand that having production and end customers on different continents makes business unnecessarily complex.

This study is the first step of getting to know the phenomenon. Theories relating to this phenomenon and also consepts had to be made clear to the author as well as readers before it can be further researched. At this stage the thesis is applicable for companies who have production in China or companies who have not yet expanded operations there but are contemplating the option of it. This research aims to reach these companies and bring to them the idea of bringing production back to the Western countries and to inform companies that have already done this, that they are the pioneers but that they wont be the only ones for much longer.

To further research this topic one needs to have connections to the kind of company mentioned in the former paragraph. With the help of a company, more specific data would be at hand as well as researching the first-hand experience from a closer perspective. In further research one could also present a model for the firms of how to implement the process of bringing manufacturing back home or to countries nearby.

5.4 Reflections of the author

Earlier in my studies I had not been specifically interested in studying Asian countries, although international business and operations have always interested me. This topic has genuinely triggered my interest towards emerging countries and their development process as well as how global businesses operate on the international market level. The process of writing this thesis has been challenging, mostly due to the structure and narrowing down of the topic. The phenomenon at hand is a very broad concept, so narrowing it down felt like leaving many important parts out. Narrowing the topic to production and viewing just China as a target country of the China phenomenon made it easier to write and to also comprehend the phenomenon as a whole – from the perspective of these two components.

The structure created some challenges as not many students of HAAGA-HELIA have written their thesis in the form of a desk study. Instructions for writing a thesis were aimed towards quantitative or qualitative researches. However, the amount of sources found about this topic made it easier to write the whole paper from a theoretical perspective. To further study this phenomenon I am planning to continue this thesis in the form of a master's thesis.

Writing this thesis has helped me improve my skills in researching. It has motivated me towards thinking about issues, such as the phenomenon at hand, in more depth. Having written numerous shorter texts during my studies, it has turned out to be a positive challenge to write a thesis of such length on my own.

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