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**PURCHASING CONTRACTS IN THE TEXTILE INDUSTRY:
HOW CAN PURCHASING CONTRACTS DECREASE
SUBCONTRACTING RISKS AND RECLAMATIONS IN A
TEXTILE INDUSTRY COMPANY?**

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As a phenomenon subcontracting is not new in the textile industry. Especially in Finland subcontracting has been used as a production method in the textile industry already from the 1950's. However, the reasons behind subcontracting have changed and the risks a textile company faces when subcontracting have become more substantial. Companies have to find ways to control these risks and studies have shown that an effective way to control the risks is to draw up an unambiguous purchasing contract.

The goal of this thesis is to examine the most important clauses of a purchasing contract that could be used as a tool to decrease the risks and the number of reclamations which are caused by these risks. This research was done by first examining the characteristics that effect subcontracting in the textile industry today; its risks and benefits, and secondly examining the theoretical framework of purchasing contracts in the textile industry. Even though purchasing contracts involve the juridical side to them by being a juridical act between two or more parties, this was not given too much attention because the viewpoint of the thesis was more commercial than juridical. The need for a commercial research of the matter came from the company, Company X, for which this thesis is done for.

The empirical study was conducted within Company X by interviewing the most important operators who will be influenced by the introduction of purchasing contracts. The results gotten from the empirical study where compared with the theory part of the thesis and similarities between the two were found. All the interviewees felt that purchasing contracts are an effective way to control the risks that are faced when subcontracting and that clauses which are meant to control the most significant risks should be highlighted using different ways such as penalties. The important clauses are delivery time and quality related clauses and clauses that discuss intellectual property rights and the ethicality of subcontracting in Company X. The interviewees also felt that the number of reclamation can be decreased by giving special attention to these clauses.

All in all the research was successful and an effective purchasing contract model was created in the process for Company X by combining the theoretical framework and the empirical information gotten through the study. However, the developed purchasing contract model was wanted to be kept confidential within Company X and that is why it is not part of the thesis.

Avainsanat: Textile industry, subcontracting, risks, contracts

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1 Introduction

In the textile industry today subcontracting is one of the only ways to survive as a small or medium sized company. Increasing prices, evanescent work force and other factors are all accumulating to especially European companies having to move production abroad. The cost of producing in Europe can't compete with the Eastern markets anymore.

The textile industry has its own industry specific characteristics that need to be taken into consideration when subcontracting. At the moment the textile industry is somewhat slow growing, unstable and quickly changing when it comes to demand; what the customers want, when and how much. The share of textiles in household budgets is resolved according to excess money available. The range of products is limited, and products are subject to rapid obsolescence and to strong seasonal or fashion-related fluctuations.

The Finnish textile industry has gone through a massive modernization process in the past few years which has decreased the number of employees by a third only from the middle of the nineties. The reason behind this process is the fact that the Finnish textile industry along with other European countries has had to start to concentrate on its core competences and start to outsource the less-strategic operations just to be able to survive in the increasing competition. It has had to fight the same battles as have many other European textile industries but a few years earlier and in the recent year the Finnish textile industry has been left behind in subcontracting as it hasn't been as developed as it is in its western neighbouring countries.

All operations which are done outside of the company inflict potential risks. Subcontracting is no exception. The most important risks that a textile company subcontracting faces are delivery tardiness related

problems, quality related risks, intellectual property rights violations and ethical risks.

These risks have to be dealt with in one way or the other; the company can shift them, decrease them or completely annul them. As annulment isn't the best solution or in many cases not even an option, many companies have acquiesced into decreasing the risks. An effective way to decrease subcontracting risks and reclamations caused by them is by drawing up an unambiguous, valuable and clear purchasing contract.

This leads me to my research question which I intend to answer through this thesis: *How can purchasing contracts decrease subcontracting risks and reclamations in a textile industry company?* My goal is to introduce the most important clauses of a purchasing contract that can be used to decrease subcontracting risks and also explain what can be done to reduce the number of reclamations. I will introduce the industry specific characteristics of the textile industry when it comes to subcontracting so that they will be set as a starting point for the contracts. With the theory framework and the information acquired through the empirical research which I intend to conduct through interviews, a model purchasing contract will be drawn up for the case study company in question. As a starting point for the study, I presuppose that the theory and empirical part will confirm my presumptions of purchasing contracts to be an effective tool to control the risks of subcontracting. However, I feel that there is a need to study the topic more from different points of view before drawing such conclusions.

The textile company I intend to use as a case study is a leading Finnish textile company (later Company X) that has been operating already since the 1950's. They manage three lines; interior decoration, clothing and bags. Subcontracting has been used as a production method from the start of the company and subcontracting affects all three lines. This textile company deals with the same risks of subcontracting as do many

other companies but they also have their own characteristics that have to be taken into consideration. The idea for the thesis subject came from Company X; they feel they are being left behind in supply chains due to their lack in an effective purchasing contract model that could be signed with all their subcontractors. As a student just starting my work life as a buyer in Company X, I have noticed the effects this lack has caused; delivery times vary greatly and quality problems have occurred. Intellectual property rights violations have also been an issue that has been discussed. Ethical problems have not yet been a risk Company X has had to face but these problems are recognized as a big risk in the future. Customers are becoming more aware and interested in the country of origin and the ethicality of Company X's products. Company X has the will to control these risks through purchasing contracts and hopes to acquire an effective purchasing contract model through this process.

The important thing to keep in mind when reading this thesis is the viewpoint from which the thesis is written from; as subcontracting risks and reclamations caused by these risks affect the commercial side of Company X's operations by inflicting financial losses and image decline, I decided to concentrate and examine the purchasing contracts from a commercial perspective. The juridical side of the contracts is also discussed and introduced but only to give a general overlook of the juridical framework which affects the contracts.

The thesis consists of four parts (see Figure 1 on page 7). The first part gives a theoretical overview of the current situation in the textile industry; the characteristics of the industry that affect its operations, subcontracting as a survival method and also the risks and benefits of textile industry subcontracting. Especially the risks of subcontracting are examined from Company X's point of view. The second part concentrates on the purchasing contracts, their content and possibilities to use them as a tool to control the risks of subcontracting. In this part also an over-

look of the legal framework of the contracts is introduced. Reclamation as a definition is also given some theoretical support.

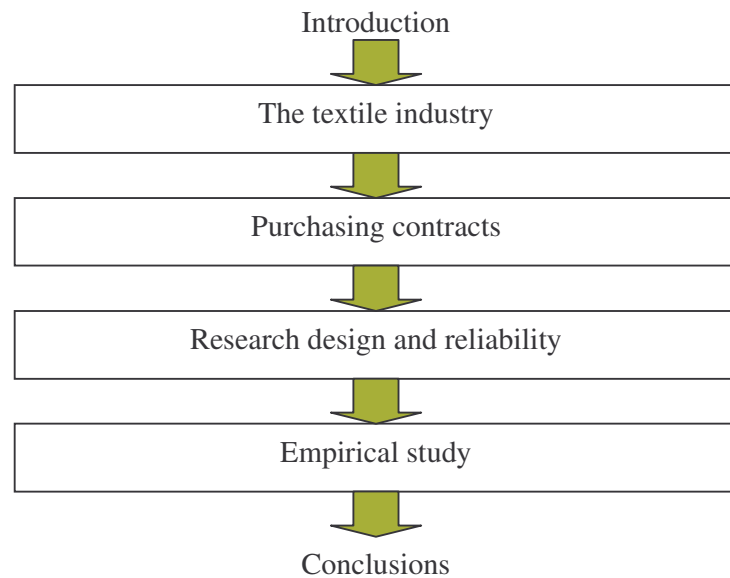


Figure 1 The structure of the thesis

In the third part of the thesis the research methods, themes and reliability of the empirical study conducted are discussed. Reasons behind the chosen research method and participants of the research are explained and methods for the analysis of the material are examined. Finally, in the fourth part of the thesis the results of the empirical study are introduced and conclusions of the whole thesis are given.

2 The textile industry

The textile industry is a very diverse and heterogeneous industry due to the fact that everyone in the world uses textiles in different shapes and forms everyday; from consumer textiles such as bed linen and clothes to industrial textiles in the chemical industry. The industry also combines its forces with different industries, for example the material to produce fabric comes from either the agricultural sector or from the chemical sector, depending on whether the fabric is natural or man-made. All in all it can be said that people and other industries alike could do very little without the textile industry as it makes everyday life possible in many ways. The textile industry is a major employer all around the world and due to companies outsourcing their activities the world of textiles is getting smaller everyday.

2.1 Background and definition of the industry

The textile industry is one of the oldest industries in the world; it has always been an important source of income for many countries, including Finland, especially in the beginning of the 20th century. In the beginning of the century almost all textiles and textile products were produced locally only for local use. In the middle of the century the industrial countries noticed the increasing competition which came from the developing countries as they could produce the same textiles and products with lower prices. The industrial countries wanted to find a solution to this problem. The Multi-Fibre Agreement (MFA) was designed to govern the textile and clothing trade with bilateral agreements or unilateral actions, establishing quotas on imports of textiles and clothing from more competitive developing countries as a mean to help the industry in Europe, for example, to survive the increasing competition. MFA lead to a situation in which the trade of textiles and clothing was unequal for the developing countries. (Understanding...2005)

The developing countries wanted to change this and so the WTO Agreement on Textiles and Clothing (ATC) came into the picture. The ATC gave the industrial countries a ten year transition period (from 1994 until the beginning of 2005) to remove unequal quotas. The ATC's aim was to free textile and clothing trade of the unequal quotas and integrate the trade fully into the GATT rules. (Textiles: Agreement ...2005)

The implementation of ATC led to a restructuring and modernisation process in the industrial countries as they were forced to come up with other ways of being competitive against the developing countries. Through the process about one third of work force were made redundant, productivity increased throughout the production chain and production was reoriented towards innovative, high-quality products. From then on European companies started to look more into the possibility of purchasing less-strategic products from outside producers (either from the same country or from around the world) and paying more attention to the company's core competencies. (Stengg 2001)

2.1.1 Definition of the industry

An accurate definition of the textile industry can be found from a survey made for the European Union's Commission; "The textile industry comprises of the following activities:

- The **treatment of raw materials**, i.e. the preparation or production of various textiles fibres, and/or the manufacture of yarns (e.g. through spinning).

- "Natural" fibres include cotton, wool, silk, flax, jute, etc.

- "Man-made" fibres include cellulosic fibres (e.g. viscose), synthetic fibres (i.e. organic fibres based on petrochemicals, such as polyester, nylon/polyamide,

acrylic, polypropylene, etc), and fibres from inorganic materials (e.g. glass, metal, carbon or ceramic).

- The **production of knitted and woven fabrics** (i.e. knitting and weaving);
- **Finishing activities** – aimed at giving fabrics the visual, physical and aesthetic properties which consumers demand – such as bleaching, printing, dyeing, impregnating, coating, plasticizing, etc
- The **transformation** of those fabrics into products such as:
 - garments, knitted or woven (= the so-called "clothing" industry)
 - carpets and other textile floor covering
 - home textiles (such as bed linen, table linen, toilet linen, kitchen linen, curtains, etc)
 - technical or 'industrial' textiles. (Stengg 2001)

2.2 Current situation in the textile industry

Today's characteristics of the textile and clothing sector are relatively slow growing, unstable and rapidly changing demand. Small quantities are bought at a time as keeping stock is expensive and the goods purchased are relatively inexpensive. This has led to a situation in which textile companies have had to come up with new ways to survive; subcontracting is seen as one of the major ways to endure. The share of textiles in household budgets is determined according to excess money available. The range of products is limited, and products are subject to rapid obsolescence and to strong seasonal or fashion-related fluctuations. Small and medium sized enterprises predominate in the textile sector. Economies of scope often exceed economies of scale, giving a certain advantage in manufacturing to firms that are small and adaptable. In these kinds of market conditions enterprises must have a ca-

capacity to constantly adapt their product mix and product ranges as well as companies themselves have to be flexibly equipped, adaptable to the production of changing ranges of goods. Strategies of flexible specialisation are seen successful through restructuring, modernization and adaptation of new technologies. (Stengg 2001)

The textile industry nowadays is still an important part of the European manufacturing industry and it employs more than 2 million people in the European Union alone. It is mostly run by small or medium-sized enterprises which are often concentrated in particular regions which contribute to the regions wealth and cultural heritage. The textile industry in the EU has undergone a change which has caused a situation where the ways of doing business have changed significantly. The same modernization and productivity increase can be seen in many European countries which in practise means that employment has gone down while subcontracting in outside countries has increased. Of course some European countries which still can compete in costs are still major players in the textile industry in the EU but mostly also these countries aren't producing products for themselves anymore but more for high-cost countries such as Italy or Sweden. Countries that still have the cost advantage are for example, Poland and Estonia but they too have to adapt their ways of doing business if they wish to keep their countries' textile industry alive. Many textile companies in the EU are concentrating on their core-competencies and also trying to find new innovations that can help them survive. Manufacturing industrial textiles have become more popular in the recent years in the textile industry as they often incorporate the high-skills of technology and know-how that can be found in the European countries. (Stengg 2001)

Most of these changes in the textile industry in the EU are caused by the ATC. China is seen as the biggest gainer because of the freeing of trade but also the biggest threat in the EU on the textile industry. Therefore the European countries have negotiated a deal with China which

states that still some restriction on imports are effective in textile trade between China and the EU. This means that the effects of the free textile trade can't be seen completely yet. The contract declares that imports of textile products and materials can't increase more than 8-12% depending on the category until the end of 2008 when all restrictions will be removed. This contract was made because the European countries weren't ready for the massive import wave of textile products and materials that started to float to the EU when the trade was freed in the beginning of 2005. China first felt that the contract was unfair but accepted it later because it had just joined the WTO and also because the textile imports from China are expected to gain over a 50% market share in a couple of years. (Saraste, 2005)

2.2.1 Current situation in the Finnish textile industry

The value of the production in the Finnish textile industry was 1.074 billion € (gross value) in 2005, which has decreased by 1,1% from year 2004. That is why in the recent years the textile industry has continued to shrink in Finland as well. The number of employees and companies has decreased every year; from 1995 to 2003 the number of employees had decreased by a third (the same trend can be seen on the EU level as well). In Finland according to the industry specific statistics, the textile industry's current situation and the future is not looking bright: due to increasing costs of producing products in Finland, companies are forced to move production to lower cost countries. This of course means that employment is going down even more; the quantity of employees in the textile industry decreased again by 2,9% from year 2004 to 2005. The development in the recent years is mostly explained by the transfer of sewing and finishing operations to lower employment expense countries such as Estonia.

The import of textiles in different forms has increased by approximately 3,8% from year 2004 till 2005 which means that the lower wage and

cost countries are taking over the manufacturing side of the textile industry in Finland. Imports (1.6 billion €) in the textile industry also greatly exceed exports (541 million €). (Tekstiili- ja vaatetusalan ry 2006) Once subcontracting was seen as a bad thing but now it is an acceptable and necessary part of the industry in Finland, it is the only way even small portion of the production worth stays in Finland. (WTO:n päätös...2005) Company operations such as designing, purchasing and selling are usually still located in Finland. Only the core competences and the internal operations of the companies want to be kept in Finland, other activities are too expensive for the companies as these expenses are hard to move to the prices of the products as consumers aren't willing to pay high prices for products they can buy for less elsewhere. (Riikonen, 2004: 12-13)

Also the textile industry in Finland as an employer isn't as attractive anymore to younger people due to its low wages (hourly wages vary from 14€/hour for men to 10,40€/hour for women which is at least 2€/hour less than in other industries) and low advancement possibilities. Therefore the average age of the employees is 44 years and the employees are mostly women in all the areas of the industry. Companies need to come up with new innovations and ideas to be able to keep at least some part of production and company operations in Finland. (Tekstiili- ja vaatetusalan ry 2006)

Finnish textile companies are small or medium sized enterprises (SME) and geographically scattered and they have gone through the biggest impact of globalization already before many of the other European countries have. Finland's textile industry has moved already from the shock phase and begun to adapt to the situation. This is why Finland opposed the restrictions on the textile trade between China and the EU. Finland feels that it can't compete with China in manufacturing. (Tekstiilikaupan...2005) Through this a realisation has come that the biggest competition isn't coming from the newly freed trade; if the trade can be

harnessed to subcontracting and it can be controlled, it can help the Finnish textile industry to launch new product and brand chains and keep up with the biggest competition which is coming from our neighbouring countries. The Finnish textile industry can't compete on prices but it can compete in subcontracting and making the supply chain more flexible and adaptable and therefore being able to keep up with the competition. (WTO:n päätös...2005) This realisation has already been visible for at least ten years as the turnover of the Finnish textile industry has continued to increase even though production is going down in Finland; when a product can be produced with the same expenses but sold by double the price, the increase in turnover is inevitable. Even though many operations, such as sewing are done abroad, almost 80% of the value of the product stays in Finland. (Kotimaista...2007)

	M€	Change 2004-05, %
PRODUCTION		
<i>Gross value</i>	1074E	-1,1 %
FOREIGN TRADE		
<i>Exports</i>	541	-2,9 %
<i>Imports</i>	1647	3,8 %
LABOUR FORCE		
<i>Establishments</i>	2180E	0,2 %
<i>Personnel</i>	9400E	-2,9 %
<i>Total wages, M€</i>	242E	0,6 %

Figure 2 Essential figures on textiles and clothing 2005 in Finland (Tekstiili- ja vaatetusalan ry 2006)

2.3 Subcontracting

Subcontracting is one of the ways a company can outsource its activities. Subcontracting definitions vary between industries and viewpoints as every industry has its own activities and distinctive nature. As a rule one could say that subcontracting is an activity between companies or public organisations in which the prime contractor (the buyer) acting as a customer buys parts, services or the whole production from the subcontractor (the supplier). The design and specifications come from the prime contractor and the subcontractor produces the goods accordingly. The prime contractor also takes care of the selling and the marketing of the goods. (Keski-Suomen TE-Keskus 2005)

Outsourcing is in many cases used as a generally applicable term with which can be referred to all activities a company is doing outside its own premises. Outsourcing is usually meant when a company subcontracts activities which are less-strategic and outside of their main area of expertise (core competences) which in return leads to a situation in which a company is more cost-effective and can concentrate only on value-added activities. (Keski-Suomen TE-Keskus 2005) Outsourcing can also be an option when the buying company has “a shortage of capacity or lack of suitable facilities”. (Baily, Farmer, Jessop & Jones 2005: 220)

According to Juha Leinonen (1996: 12) the difference between purchasing and subcontracting is in the buyer-supplier relationship; when specific information is given to the supplier from the buyer, for example product specifications, the relationship can be seen as subcontracting. The relationship is deeper in subcontracting than it is in an off-the-shelf purchasing relationship. However, subcontracting is separated from joint-venture in the sense that in joint-venture the buying company provides equity for the supplying company and in subcontracting this is not

done. Both companies are independent from each other and have chosen to operate together to make buyer specific products.

There are many different motives for subcontracting: in addition to quality, cost and availability of products, materials or labour some companies pursue purchasing and subcontracting as a supply base management strategy. "They try to find additional supply sources or increase competition among domestic suppliers and thereby leverage their own competitiveness." Subcontracting is sometimes also used to gain access to "new sales markets or to support current marketing and production operations abroad". (Leinonen, 1996: 14-17) Also an important motive to keep in mind is that prime contractor companies know that certain activities can be done far better by subcontractors working only in their specific area of expertise. In practise this means that a textile company that wants to have porcelain objects in their collection will go and find a porcelain subcontractor that already has the expertise of handling and producing porcelain products. This is much more financially profitable than opening up an own porcelain company, for example. The motives for subcontracting differ according to the size of the company and also to the industry sector in which the company operates in. (Oates, 1998: 41-65)

Subcontracting, however, has its problems as well: the main problem is the management of the supply chain. Long distances between buyers and suppliers may cause inaccurate deliveries, long lead-times, additional inventories and inflexible schedules. Also cultural differences, language and communication obstacles and political attitudes on both the purchasing and the supplying country may cause problems in subcontracting. Quality and cost are also both seen as an advantage but also as problems as quality control can be hard and expensive due to distances and the price of the product may rise due to hidden costs of subcontracting such as unexpected fluctuation of exchange rates. (Leinonen, 1996: 20-23)

“In today’s highly competitive and core-competence focused business environment, companies are increasingly outsourcing non-core activities and thus relying on the supplier competencies. As stated earlier, a company’s competitiveness is no longer dependant on only its own capabilities but also heavily influenced by the suppliers base competency, and by how well the company is able to manage its supplier relations.” (Seppälä, 2001: 14)

2.4 Subcontracting in the textile industry

As explained earlier, subcontracting is a notable and necessary outsourcing method in the textile industry as well. It has the same motives for it as do many other industry fields, but in the textile industry there are also industry specific motives for subcontracting due to the nature of the industry. The nature of the industry demands capacity from the companies to constantly adapt their product mix and ranges and this is why subcontracting is such a big issue in the industry. (Grundström, 2004: 12-28) The companies outsourcing are looking for subcontractors that can produce the goods or materials quicker, possibly cheaper and more flexibly. This is why most companies in the textile industry are small and adaptable. Also the quality of the goods or materials is important. In many cases the subcontractors are better in what they do than the company outsourcing. As the textile industry is highly work force directed, the cheap labour force which is available in developing countries is another motive for subcontracting in the textile industry. (Burkholder, 2006: 29-47)

Due to the WTO’s Agreement on Textiles and Clothing, the world of textile trade has become smaller in the past few years. Companies are purchasing products from countries that are relatively far away from the purchasing company’s home country. The main reason for Finnish textile companies subcontracting in China for example, is price. The work

force is cheaper and the materials are less-expensive. Also a major reason for subcontracting in other countries is infrastructure; the machinery needed might not be available in the buyer's home country. (Grundström, 2004: 28-47)

In Europe subcontracting in the textile industry is mostly used in finishing and in the made-up articles sector. Subcontracting firms vary in size, activity, development and relation within the industry. (Commission of the European Communities 1996.) Subcontracting is a trend in the industry and it is expected to grow even more as every step of the supply chain is hoping to decrease its own risk and make their own part of the chain more efficient, leaving the subcontractors holding the biggest risk in the supply chain. (Riikonen, 2004: 13-14) Subcontracting employs almost 650 000 people in Europe alone and although specific statistics can not be found on the quantity of employees on a world status, without a doubt it can be said that in the textile industry subcontracting is one the most employing area of business. (Commission of the European Communities 1996.)

Finnish textile companies started to subcontract their products relatively early comparing with other European countries but as it was such a slow and un-designed process. When for example, our neighbouring countries (for example, the Swedish interior decoration giant Ikea) started to subcontract their products, the Finnish companies were left far behind. That is why in Finland the relationships formed between the prime contractor and the subcontractor is often fairly weak and this hinders the relationship. (Grundström, 2004: 100-118)

In Finland subcontracting as a manufacturing strategy in the textile industry has varied through the years. In the 1960s and 1970s Finland was the subcontracting country for Sweden, which later in 1980s moved away due to risen labour expenses. During the same time Finnish manufacturers began their first experiments of subcontracting abroad.

So called “golden times” for Finnish textile industry were late 1970s until mid 1980s as a result of bilateral trade agreement with Russia linked with favourable pricing terms, which released the textile industry from the many risks of the market economy. Later in the early 1990s, the trade with Russia collapsed and industry participants were forced to find new forms of cooperation, which were found from Karelia and Baltic countries. Estonia became one of the most popular markets for manufacturing activities due to availability of free and cheap production capacity and skilled women labour force meeting the needs of Finnish textile industry. Cooperation with Estonian firms was also easy since the cultural as well as language barriers were reasonable low. Some requisites were created through legislations enabling the duty-free importation of garments manufactured in Baltic countries, Russia, Poland, Slovakia, Hungary and Turkey (Lex Vateva 1992). Joining to EU has made duty-free importation possible for the Finnish textile companies from other member countries with cheaper labour costs, e.g. in the Mediterranean area (Portugal, Malta, Greek and Turkey). Also the Finnish textile companies have been searching for cost benefits through subcontracting from Asia. (Grundström, 2004: 12-28) Nowadays also new EU countries are interesting for the Finnish textile companies. Countries such as Romania and Ukraine are still relatively inexpensive when it comes to subcontracting but also they have the advantage of being closer than China, for example. (Riikonen, 2004: 13) In Estonia the cost of work is 1/6 compared to Finland and in Portugal the same work can be done by a quarter of the same in Finland. These figures are also presented in Table 1. (Tekstiili- ja vaatetusteollisuus ry 2006) In Finland subcontracting is used in the textile industry in operations, logistics and warehousing more than in the world on average. (Karkaako laatu...2004)

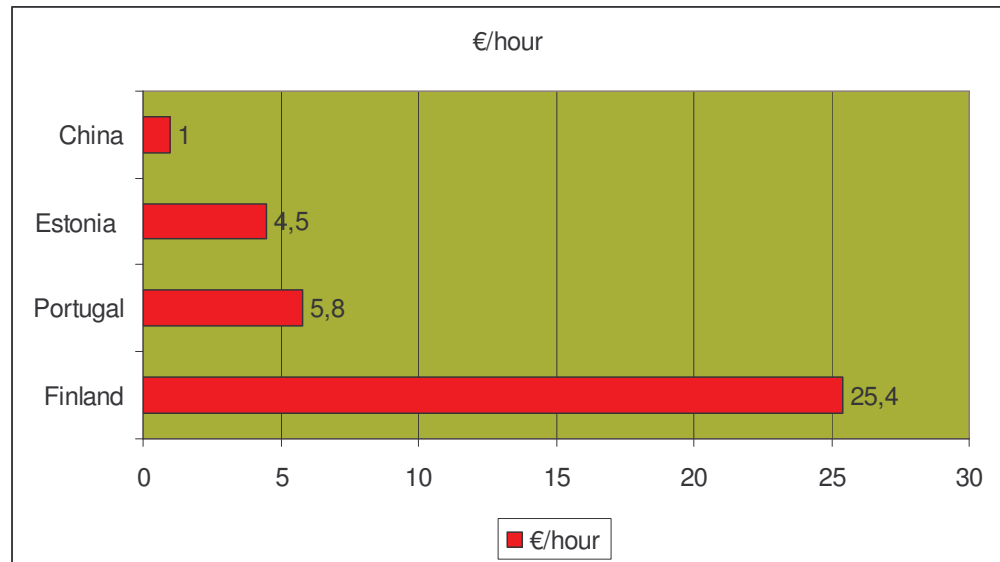


Table 1 Wages and labour costs in different countries, industrial workers 2005

(Tekstiili- ja vaatetusteollisuus ry 2006)

2.4.1 Ways to subcontract in the textile industry

In a Danish research, three ways of combining subcontracting in the textile industry and the company's own operations were found;

- Outward Processing Traffic/Transactions (OPT) which means that the materials and specifications are sent out by the buyer to the supplier already cut into pieces etc. (subcontractor)
- Cut, Make and Trim (CMT), means that only materials are sent to the subcontractor
- Sourcing from Own Design (SOD) means that the design and specifications are sent to the supplier by the buyer and the supplier produces the products accordingly from start to finish (Riikonen, 2004: 14)

These three are the most used ways of subcontracting in the textile industry which is also stated in a survey done by the Commission of the

European Communities which suggests that OPT imports to the EU alone amounted for 11.3 billion dollars in 1999. However, the tendency has been to shift the risk of cost from prime contractor to subcontractor by ordering ready-made products manufactured by a subcontractor according the specific instructions of a prime contractor (SOD subcontracting). (Commission of the European Communities 1996)

2.4.2 Risks of subcontracting in the textile industry

Unfortunately all activities happening outside a company's premises has it's risks, the same applies to subcontracting in the textile industry and especially while operating internationally these risks can be even bigger. A risk is a possible and unexpected loss. And the main idea of controlling risks is to take them to a level that is acceptable and bearable for the company. A risk can occur in all the phases that take place in international operations, for example in the designing phase and in the pricing phase. There are different kinds of methods to control the risks that might occur. The company can, for example, avoid the risks or divide the risks. In every situation, avoiding the risk might not be the best practise for the company. Controlling contracts and the contracting techniques is an effective way to control risks and when all possible risks are mapped out, they can be controlled and dealt with contracts very effectively. (Pasanen, 2005: 185-190) In the following the biggest risks that can be faced when subcontracting in the textile industry are examined in more detail.

The benefits that can be got from subcontracting are obvious; same quality products at cheaper prices, possible access to new markets, shorter lead-times and the company can focus on its core-competencies. There are also possible problems that can be faced while subcontracting in the textile industry. Some problems are clear, such as how to anticipate the needs and wants of the customers in a rapid pace without any delays or mistakes in quality. Problems that also

might arise from subcontracting, but from a different perspective than quality and tardiness issues, are social and ethical responsibility related issues and problems with trust between the prime contractor and the subcontractor, mainly resolving in violations against intellectual property rights. These issues have been a major topic of discussion in the recent years among the textile industry but also among the public.

Delay in delivery related issues can be a major risk effecting subcontracting in the textile industry as in many cases products are produced according to the buyer's specifications and also for a specific time schedule (a new collection launch or a campaign). If a supplier is late from the agreed delivery time, the problems arising from the tardiness can be multiplied as supply chains have become longer in the recent years. (Hugos, 2003: 84-90) Suppliers that can react promptly and accurately to the needs of their customers are more likely to attract new customers and new orders from old customers, then those suppliers that can't. It has been said, that before price was paramount as an influencer on the purchase decision, nowadays, while price is still important, being on time and the cost of time has become more important. Cost of time is the additional costs that the buyer must bear while waiting for delivery. How can a supplier respond to the buyer's time related requirements? Traditionally suppliers held stock but nowadays keeping stock isn't an option as it is so expensive, therefore the supplier itself has to have suppliers that are quick to respond to its needs. Being on time is a standard purchasing objective and if this objective isn't achieved, sales can be lost, not only on the suppliers side but also on the buyer's side, production halted and the efficiency of the organizations can be reduced as a whole. A tolerance on tardiness has to be achieved as it is impossible to always be on time and therefore it is the buyers responsibility to decide what is needed and when and inform this to the supplier. If the supplier agrees to the time table given by the buyer and still is late, then it is seen as a reason for compensation or

other actions from the buyer's side. (Baily, Farmer, Jessop & Jones 2005: 160-176)

What is quality and when is a violation on the quality demands of the purchasing company made? Quality is always defined by the purchasing company with specifications and characteristics given to the supplier. Quality is a compromise; the buyer has in mind a set of requirements for a product, the supplier answers to these requirements as well as the supplier can and the buyer has a company specific tolerance as to what kind of quality is accepted. However, the wanted requirements might not be answered due to price related issues, for example. Quality in different companies means different things and in the textile industry; the requirements for quality come from the customers and from the market for which the goods are intended for. There are different quality characteristics that can be weight differently according to the customers and the market. These are, for example; affordability, safety and degree of uniqueness. Again, these characteristics are defined by the purchasing company: if the company wants children's bed linen, the quality has to be safe for children and if certain uniqueness is wanted in the same bed linen, it can be achieved through the choice of the fabric, for example. The market and the customers have to be fully investigated before specifications are made and each characteristic of quality has to given a weighting, so that the compromise is acceptable, and that the resulting balance agrees with the purpose of the good. However, no one can make everything perfectly and also the tolerance of mistakes should be included in the specifications given to the supplier by the buyer. If the specifications and requirements aren't followed, a violation against the quality demands of the purchasing company can happen. All in all, quality is a co-operation process, which happens throughout the supply chain and tolerance levels must be set incisively so that violations don't occur or that they can at least be decreased to a minimum. (Chuter, 2001: 2-19)

Problems with intellectual property rights violations are common in the textile industry as many subcontractors operate with different kinds of textile companies; some companies give broad-minded instructions for the subcontractor as to how their products should be produced and some are very precise with their instructions and specifications. This can cause confusion with the subcontractors and they may not even know that a design which has been given to them to produce is protected by intellectual property rights if this has not been specified. There are many situations that can be seen as intellectual property right violations, in all the cases the violations aren't consciously done but unfortunately in some cases they are; designs and products are copied to look exactly as the original, especially in the Far-East. (Nykänen, 2006) An intellectual property violation could occur, for example, when a subcontractor consciously makes the decision to produce another company's designs for other purposes than to sell to the IPR's owning company. Also an intellectual property violation can happen when information related to the production of a product (sewing instructions, for example) is given to a 3rd party without permission from the prime contractor. Usually the 3rd parties involved can gain financially from the knowledge gotten from an IPR violation and usually IPR violations hurt the prime contractor either financially or "emotionally" (image decrease etc).

When a company doesn't know where or by whom, their products are produced by, this can result in ethical problems. Ethical problems are common especially in the less-developed, low-cost subcontracting countries that are attractive for high-cost countries to subcontract in because of low prices and high quantity of workforce. These countries' subcontractors have the tendency to offer high-cost countries' companies products at a certain price and then when the offer is accepted, they start to source the product and produce it were it is the cheapest for them. It is unfortunately common that the cheapest price amounts from poor working conditions for the employees and in some cases also from child labour. Companies such as Ikea, H&M and Nike have all

fallen into the same pit of not finding out enough of the company subcontracting in the first place and then publicly getting caught of using for example child labour or other ethically questionable methods in the supplying company. In Finland it is also unfortunately common for a company not to know the exact origin of the product while purchasing it and therefore being exposed to accusations of ethical and social negligence. (Grundström, 2004: 118-138) Ethical problems are a popular topic for discussion nowadays and that is why many companies have started to give more focus on these matters. The Finnish division of the International Chamber of Commerce for example has drawn a contract that has been signed by many Finnish textile companies that states the ethical conditions in which these companies try to produce their products. (Vastuullisen tuontikaupan periaatteet 2006)

There are many other risks that can arise from subcontracting in the textile industry, such as price related risks (what if the supplier raises its prices significantly), legislation related risks (what if the legislative environment of the subcontractor's country changes considerably) or quantity related risks (what if the supplier delivers too much or too little quantity of the goods ordered). All of these risks can be controlled with a purchasing contract fairly easily. (Pasanen, 2005: 185-190) The risks introduced in more specific are risks that the case company has had to deal with the most.

3 Purchasing contracts

3.1 What is a purchasing contract and how is it made?

Operations which were once apart of the company are now trusted more and more in the hands of outsiders (outsourcing). This is happen-

ing inside and between the public and private sector, as well as in municipalities, industrial, trade and service sectors. When internal operations are moved away to customerships and partnerships, the leadership ways of yesterday don't apply anymore. The content of the cooperation and the services, obligations and responsibilities limits and many other issues have to be defined more specifically than before. An effective way to define these issues is by drawing up an unambiguous contract. Before contracting was seen as a juridical operation only but nowadays more attention is given to, for example, the commercial side of the contract. A well functioning contract cannot be drawn without considering the organizations or industry's operations and characteristics. In the article Helena Haapio gives a graph which simply divides the contract into two parts:

- the technical part of the contract (including, for example, the specifications for the object of the contract and the vastness of the object)
- commercial-juridical part of the contract (including, for example, the payment terms and the obligations and responsibilities of the contracting parties in a dispute situation)

These parts are linked together as a puzzle as described in Figure 3 on page 25 and are different in every contracting party. The important thing is that the parts are compatible in content and definitions. In a good contract these parts are in a clear and functioning order. Also both parties should understand the parts the same way. The primary starting point for the contract is the question of what the parties are about to do. Also a good contract operates as a safety net and answers questions such as what if (what if the co-operation ends etc) and what if not (what if the object of the contract isn't delivered in the right time etc). (Haapio, 2006)

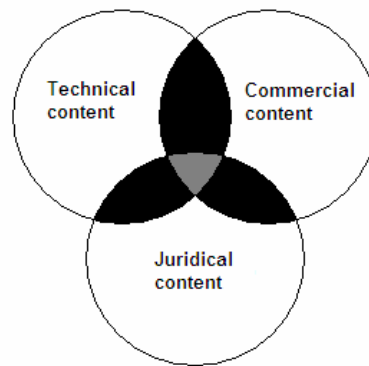


Figure 3 The different part of a purchasing contract (Haapio, 2006)

From a legislative point of view a purchasing contract is a juridical act which is formed in between two or more actions that precede each other. And from a commercial point of view it is the most important way a company can protect itself from potential risks which might occur while operating with subcontractors. (Piksilä-Rantanen, 2006)

Every purchasing order is a contract. A purchasing contract can be drawn when:

- a binding offer is issued by the supplier and the buyer gives an order which has the exact same content than the offer
- the buyer begins to use a service according to the suppliers offer
- the buyer sends out an order and the supplier gives an order confirmation to the buyer
- the buyer sends an order and the supplier sends the goods
- a contract is drawn which both, the buyer and supplier approve and sign

In the following I will concentrate on the latter of the options; the individually drawn contract as it corresponds mostly to the needs of the case company in question. However, all rules, laws and regulations

mentioned will apply in all of the above situations, only in the individual contract these rules can be decided on differently than according to the law. This is possible as the laws on contracting aren't forcing. (Piksilä-Rantanen, 2006)

For who are contracts made for? The need and function of a contract differs from a company to another. The function differs in managing operations, making profit, controlling risks, preventing disputes and solving disputes. The users of contracts also differ in companies but usually contracts are used by the personnel of the contracting companies (managers, buyers, lawyers, financial side employees etc) but also outside operators might be interested in the contract, for example, authorities and tribunals. Every now and then unfortunately there are situations in which the internal users of the contract don't know what the other users are doing and disagreements can occur which in many cases amount to reclamations. (Haapio, 2006)

In business-to-business transactions all trade is usually based on written agreements but oral contracts apply as well looking from a juridical point although they can be very tricky to prove. Among other things the contracts object (i.e. what is wanted to be agreed on), the expected duration and the laws which will be applied to the contract determine how specifically the contract should be drawn in different situations. However, it is advisable to document at least the corner stones of the transaction and the material that has been accumulated during the contracting process. (Pasanen, 2005: 102-103)

3.2 Laws and legislations affecting the purchasing contract and the choice of the law

In international and national trade the significance of the law applied and the questions concerning the solution of disputes is usually emphasized when a dispute situation is at hand. If the purchasing contract is

drawn up comprehensively enough and especially if the parties have understood the terms of the business transaction in the same way from the very beginning, the meaning of the legislation complementing the contract might not be necessary to think about at all during the contracting relationship as the rights and obligations of the parties are defined in the contracting terms. When the contract is clear enough on all matters necessary, a dispute situation can be fairly easy to settle and it can save a lot of money and time for both parties. However, even with the best and most comprehensive contracts every now and then a company can find itself in a dispute situation where both parties are absolutely sure that they are right. (Pasanen, 2005: 79) Then not only what is written or otherwise agreed on between the contracting parties is looked at but also other factors come into the situation which are used to fill in the blanks but also to help the interpretation of contract, in the following hierarchy as described in Figure 4:

1. binding laws and legislation
2. trade practises
3. non-binding laws such as the Finnish National Commercial law and the United Nations Convention on Contract for the International Sale of Goods (Haapio et al, 2005: 55)

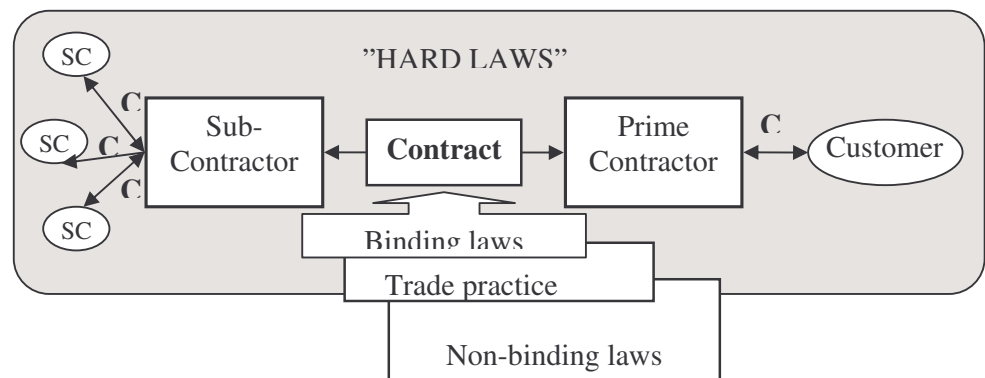


Figure 4 The legal framework of contracts. (Adapted from Haapio et al, 2005: 55)

Binding laws and legislation are laws that can not be deviated with the contract drawn between the parties. Binding legislation sets boundaries for contracting freedom and usually is meant to protect the weaker party and also in some cases to maintain fair trade. As an example copyrights can be mentioned. (Pasanen, 2005: 80-81)

Trade practice is an established and reasonable way of doing business which corresponds to the laws and legislations that are currently predominant. Trade practices are for example industry specific standard contract terms which in some industries might affect the way the contract is interpreted even though the whole contract might not have any reference to the standard terms. Many court rulings have been made of this kind of situation where the court has seen that both parties should have been aware of the standard terms and what they rule in whichever situation when both parties are operating within the same industry. Another situation that could be counted as a trade practice could be the use of Incoterms. The problem with trade practices are that even though they weigh a lot in the scale in the opinion of a court, they are still very hard to prove. (Kettula, 2006)

Laws and legislations that can be agreed on differently are called non-binding laws. These laws are not applied to the contract if otherwise has been agreed in the contract. If the contract is narrow in its nature then the importance of the non-binding laws increase as the missing gaps are filled in with legislations on the matter. (Pasanen, 2005: 80-85) Such laws are for example the Legal Transactions Act, The Finnish National Commercial Code and United Nations Convention on Contracts for the International Sale of Goods (CISG) which has been ratified in Finland with a few amendments. The Legal Transactions Act deals with the actual process and form of the contracts and the two Trade Laws with the actual process of trading on a national level and also on an international level. (Haapio et al, 2005: 196) In the following I will examine the two latter more specifically as they are seen as the two legislations

that affect trade the most in Finland and also they are the most commercially significant laws in Finland. In Finland both laws are valid and applied but in different situations. (Kettula, 2006)

The first question is the choice of law: what law applies and when? The principal rule is that the law which is in force in the supplier's country is applied to the contract if nothing else is agreed on. If the contracting parties agree on another legislation to be applied to the contract it should be mentioned specifically in the contract. In general contracting parties can decide to use whichever law they please with the exception that a law which is against the buyer or the suppliers own countries principals in anyway should not be used. To ease the uncertainty surrounding the choice of law, Finland has directed a law based on the Hague Convention and also a law based on the Rome Convention which both state that the contracting parties have the right to decide on the law applied themselves and if nothing is mentioned in the contract the law which is in force in the suppliers country should be used. (Pehkonen, 2000: 83-86) The choice of law should not be mistaken to also answer the question of the country and court system in which possible disputes will be settled, this question is discussed briefly when introducing the different parts of the purchasing contract.

One other way Finland and many other countries have tried to ease the confusion involving international trade is by ratifying CISG. The main reason behind CISG was and is to harmonize the legislations which apply to the international sale of goods and also to promote and ease international trade. CISG helps trading partners to predict the interpretations and outcomes in dispute situations. Almost 70 countries around the world have ratified CISG, excluding such countries as Portugal and Great Britain. In countries which have ratified CISG it has been a basis for the constitution of the National Trade Law. (Kettula, 2006) The same situation is in Finland where The National Commercial Code has been

constituted on the basis of CISG with the dissimilarities made on purpose. (Pasanen, 2005: 641-643)

CISG is applied when the contracting parties are situated in different countries and both of the countries have ratified CISG or if the contracting parties agree on using CISG even though it might not be ratified at both ends. If the parties agree on using the Finnish Law in general, then CISG is applied with the reservations which Finland has made to it (Finland along with the other Nordic countries have made the same amendments to CISG to ease trade between the Nordic countries). Then again if the National Commercial Code is wanted to be used then it should be mentioned specifically in the contract. Also if the parties want to use CISG as a whole without the amendments it should be mentioned clearly in the contract. (Paajanen & Saarinen, 1997: 46-49)

CISG comprises of three parts; the first part discusses the extent in which CISG is applied and CISG's general instructions, the second part discusses the process of making a contract and the third the orders which are connected to the sale goods. In short, CISG lists the obligations and responsibilities of both, the supplier and the buyer. CISG has been said to be fairly buyer friendly and that is why many suppliers try to avoid using it. CISG can only be used in trade that involves goods; it can not be applied in trade that involves some sort of services. The amendment that the Nordic countries have made is in the second part of CISG. (Paajanen & Saarinen, 1996: 48-50) Even though CISG is the same in all the countries it has been ratified, the legal traditions of the countries still affect the way CISG is applied. CISG has been criticized of being too vague and therefore leaving room for the legal traditions to be able to effect the interpretation of CISG. (Kettula, 2006)

The Finnish National Commercial Code came into force on the 1st of January 1988. It is applied when doing business inside of Finland and also in trade between the Nordic countries if there is a remark that the

National Commercial Code will be applied as all the trade laws in the Nordic countries are very similar. As the CISG, the Finnish National Commercial Code lists the obligations and responsibilities of both contracting parties and it can only be used in trade involving goods. It is also a non-binding law which can be bypassed with trade practises and what is agreed in the contract. When the National Commercial Code was composed it was done by keeping an eye on international trade but it is a product of many negotiations and compromises. That is why there are some intentional dissimilarity between it and CISG. (Rautio, 2002: 7-8)

3.3 Different types of purchasing contracts

Even though there are many different types of contracts, the name and title of the contract doesn't affect the content of the contract. Under one title, there can be many different kinds of contracts. There aren't legislations concerning the different types of contracts; all contracts are dealt with under the same legislation. (Blankenstein, 2006)

3.3.1 Preliminary agreement

When a company is planning on purchasing materials, services or goods from a supplier, a preliminary contract is sometimes drawn up. Its main idea is to give notice to the supplier that the goods will be ordered if a particular issue or clause is fulfilled. A clause such as this could be, for example, the drawing up of the final contract or that the supplier has to give proof to the buyer of its abilities to perform the requested services, or deliver the materials or products. If a preliminary contract is drawn, by signing it, the supplier commits itself to fulfil all the clauses that would be in the final contract and if the buyer doesn't hold up to its part of the deal, it is obliged to compensate for it according to the preliminary contract. (Blankenstein, 2006)

3.3.2 Single order -contract

The briefest type of purchasing contract is a single order contract. Single order contracts are drawn up almost daily in purchasing departments and they form the most significant part of many companies' contract bases. Therefore also these contracts should be drawn up carefully. The main idea of a single order contract is to give unambiguous operating instructions for the supplier to produce and deliver materials, ready-made goods or services. Typical to these kinds of orders are that the value in euros is fairly low and that the contracting parties have done business before and so the rules are known by both parties. A contract such as this can be described mostly as commercial. (Sakki, 1982: 91-138)

3.3.3 Yearly contract

The goals and benefits of a yearly contract are;

- decrease the quantity of orders
- lessen paperwork
- entitle to the quantity discount that are achieved through big order quantities
- clear delivery schedules
- continuous but "thin" stream of materials or goods from the supplier to the buyer, shifting the cost of warehousing to the supplier
- small single delivery batch
- no need for big warehouses
- small costs (Käyhkö, 1970)

Yearly contract are usually used in companies that practise serial production and don't have a lot of campaigns or special products in their collection that change from time to time. A yearly contract is formed from three parts; the sales contract, the quality contract and the after-

sale contract. (Koskinen et al, 1995: 176-182) A yearly contract should be checked yearly and all matters should be agreed on specifically; prices, discounts etc. The quantity of the order is left open or it is given minimum or maximum limits. The fundamental part of yearly contracts is that they are made before the buyer can specifically define when and how much will a certain material or good be ordered. This is also the down side of yearly contracts, sometimes they are seen as too controlling and restricting. (Sakki, 1982: 112-116)

3.3.4 General agreement

A general agreement has all “the clauses that apply to all trade that happens between the contracting parties”. This kind of a contract is especially typical in service trade but general agreements are becoming more and more used in other types of trade as well. When there are a large number of orders issued to the supplier all the time, a general agreement helps the process. (Blankenstein, 2006) In many cases general agreements help the buying company to keep track of their contracts (contract management) as many companies use the same contract base for all suppliers with only small parts of the contract that can be negotiated differently with the supplier in question. (Haapio et al, 2005: 330-342) In the general agreement all obligations and responsibilities of the parties are discussed but the general agreement isn't valid until an order is given which refers to the general agreements clauses. Companies might also include other completing objects to the general agreement such as an obligatory order confirmation in a specific time frame from the supplier. This way both parties can secure their part of the contract; if the buyer doesn't provably give out an order, the supplier hasn't got any responsibilities and the buyer can't issue any claims against the supplier. The same applies with the order confirmation. (Blankenstein, 2006)

The benefits that can be gained from a general agreement are much the same as with a yearly contract, but other benefits can also come from using a general agreement. For example the controllability and steerability of the materials and goods purchased can be increased and also prices can be negotiated constant and in a situation in which prices have a tendency of going up, the buying party can gain advantage from this. In a company where many materials and goods are bought from the same supplier, a general agreement helps the order process (as described in Figure 5) as only the very basics have to be included in the order itself and all the details can be found from the general agreement. A down side of a general agreement might be the decrease of control in the purchasing operations. (Koskinen et al, 1995: 176-182)

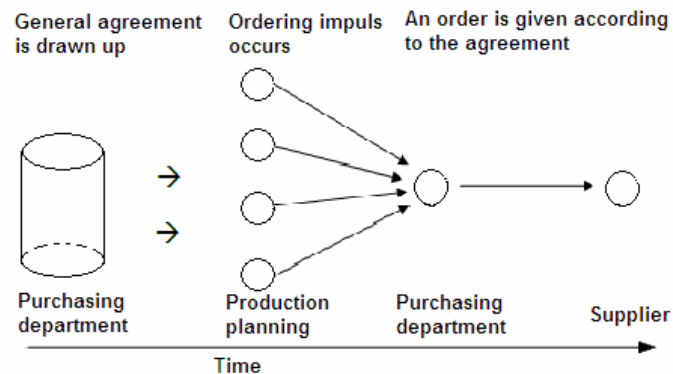


Figure 5 Ordering process when using a general agreement (Sakki, 1982: 114)

As Company X is interested in having a general agreement as their contracting base to clear the whole process of contracting from the negotiations to the actual use of the contract, I will in the following present the different parts of a general agreement. But as said before, the following clauses can be found in all the other contract types presented above as well but they can be just as easily left out of the contracts; every company decides for itself.

3.4 The different parts of contract

Every company has a different kind of purchasing contract as every company is different and every company has different important matters that have to be included in the contract (if, for example standard contracting terms are used etc.). As Company X in this final thesis is a company operating in the niche of the textile industry different factors affect the parts of the contract as explained in part one “Subcontracting in the textile industry”. In the following the parts important specifically for a textile company will be examined and listed, also taking into account that the need within Company X.

As clarified by Heli Rantanen-Piksilä agreeing on specific details is risk management; the company is prepared for any kind of risk it might face when operating with its subcontractors. But before the company can start to manage its risks it first has to identify the main risks it can face and also decide and examine how these risks can be managed. To make sure that the contracts counter party also understands what risks the company wants to avoid explanatory clauses such as “ For avoidance of any doubt the parties state that...” which means that the juridical meaning of a clause is opened by stating it with everyday language.

The fundamental principle is maintaining the contractual balance between the “output” received and the “input” invested. Kurkela (2003: 56) presents a simplified division of matters agreed in a contract:

- 1) The obligations of the parties (content of a performance)
- 2) The consequences, if the contract is not fulfilled as agreed
 - a) on default of a party
 - b) due to some other reason
- 3) The other terms and conditions (boilerplates)

Contracting parties and an introduction

The first thing that has to be mentioned in the contract is the contracting parties (contact persons and contact information). This defines who buys and who supplies the goods. This part of the contract is sometimes called an introduction and some parties want to include an informative few lines as to who is obliged to buy and sell according to the contract etc. Also possible third parties should be mentioned already in this part. In Company X the purchasing department as a whole is marked as the contact person due to rapid changes in personnel. (Piksilä-Rantanen, 2006)

Definitions

Definitions can help the contracting process as they help everyone understand the contract better. Also important issues to the contracting parties can be highlighted by giving specific definitions of them. Apparent definitions can be interpreted completely differently in different situations and that is why definitions should be unambiguous. The same definitions should be used throughout the contract and always when using a definition it should be highlighted with a capital letter. In Company X, for example, intellectual property rights (IPR) are a major issue and by giving a definition to it, Company X can highlight this important issue and also be sure that both parties know what is meant by IPRs. (Pasanen, 2005: 118)

The object of the contract

By stating what is actually agreed on in the contract, the supplier and the buyer get obligations and responsibilities according to which they act on. The operations which are needed to perform for the contract to be valid are also written in this part; the general agreement sets the rules which are applied to the orders that the buyer gives out and to which the supplier responds to. (Piksilä-Rantanen, 2006)

The origin of the contract

To make sure that the contracting parties know when the general agreement's terms apply, it is important to explain the different situations in which the terms are referred to. It must be clearly stated that the general agreement isn't a contract by itself but that it is a part of the contract when for example an order is given to the supplier. In the general agreement for Company X there are three parts that form the actual contract:

- the general agreement and its clauses
- a cover page on which all the amendments that were made to the general agreements clauses are listed
- the order given to the supplier by the buyer

When a demand for an order confirmation, for example, is introduced, also the requirements for it to be exactly as the buyer wants, should be brought up; such as the order confirmation should be delivered to the buyer within 8 days of the order and if so is not done, then the order is seen as confirmed as it is. (Piksilä-Rantanen, 2006)

Payments and the content of an invoice

In the terms concerning the payments, the currency, the time of the payment, the method of the payment (e.g. cash in advance, payment on account, letter of credit) and the place of the payment should be agreed on. (Pasanen, 2005: 114) The terms of payment and the delivery are considered to go together as they are both linked to the shift of costs, risk and title (Haapio et al. 2005: 133). The consequences of payment delays need to be determined e.g. penalty interest. Also if an advance is required, it should be cleared in the terms affecting the payment (Paajanen & Saarinen, 1996: 333-335). The content of the invoice is important for Company X as they have many buyers within the same company purchasing different materials and goods from the same supplier and it is important for the finance department to see straight from the invoice to which buyer the invoice belongs to.

Terms of delivery

The definition of time and method of the delivery is many times determined by the features of the products delivered, by geographical locations of the buyer and the supplier as well as by the level of the risk of transportation of products. The Incoterms 2000, developed by the International Chamber of Commerce (ICC), have established its position as standard terms for international deliveries. In Finland, in domestic deliveries, Finnterms 2001, which are developed in cooperation with logistic sector, are recommended to be used (Haapio et al. 2005: 133). These standards define the division of costs and risks during the transportation. Sometimes it is not possible to agree on certain time for delivery and different kind of clauses can be used to limit responsibilities.

Delivery time and being late

In this part of the contract the parties agree on the delivery time, what is seen as a delay and also on the consequences that occur if the supplier is delayed from the agreed delivery time. The contracting parties can agree that the delivery takes place according to a specific timetable negotiated between the parties or after a specific time the supplier has received the order from the buyer. In some cases it is important to agree that the delivery can not take place before an exact time to, for example, keep warehouses from getting too full. (Paajanen & Saarinen, 1996: 82) If the supplier is late, the buyer has a right to claim a contractual penalty and get a compensation for loss of sales, for example, from the supplier. The buyer also has a right to require the supplier to deliver the goods as soon as possible or if the delay is more than four weeks, the buyer has a right to cancel the order. If the supplier is late, it has an obligation to do everything in its power to deliver the goods as soon as possible or if the reason behind the delay is "out of its hands", appeal to a force majeure clause if the supplier isn't able to fulfill its obligations.

The supplier is seen as being late if the delivery isn't fulfilled as agreed or if it hasn't informed the buyer in reasonable time that the delivery

time isn't going to be fulfilled and if a new delivery time hasn't been given to the buyer. (Piksilä-Rantanen, 2006) If time for delivery is not determined, it is defined by the commercial law (law applicable) and/or international law (CISG), which both enhances the principles of rationality (goods are to be delivered in reasonable time). However, this is argued to be too vague and to create questions about, how "reasonable time" is to be defined. That is why established standards are recommended. The delays in deliveries can be determined more precisely when the time of delivery is bind to certain event of time (Haapio et al. 2005: 29).

Title and risk of loss

From the view point of risks and responsibilities of the parties, the transfer of title and risk should happen simultaneously. Although, this is not necessarily always so, since the risk transfers according to the terms of delivery (Incoterms 2000) and the title is determined by the parties or by the law applicable. The title is considered to transfer when the obligations of the contract by both parties are fulfilled, thus the buyer has received the goods and the supplier the payment. However, in a case of involvement of third parties e.g. in a case of bankruptcy, the laws applied are related to bankruptcy and regional legal system, where the bankruptcy has happened. For example in a situation, where the buyer and the supplier have agreed on credit trade and the title shifts at the moment the supplier receives the payment, if before the payment is conducted, the supplier is declared bankrupt, the goods are considered as a property of bankrupt's estate and the buyer loses its title to goods even though the buyer has paid for the goods. The transfer of the title thus can be agreed in contracts. (Pasanen 2005, 113) In Company X's general agreement a clause easing the situation in which the supplier's company is declared bankrupt, has been included stating that the buyer has a priority right to buy ready-made goods and materials which are made according to the buyer's specifications. This clause includes all

the property that has been sent to the supplier by the buyer to be able to produce the buyer products or materials.

Insurances

It is important to agree in the contract who is responsible to take which insurances. Insurances that should be agreed on are, for example, transportation insurance, general third party insurance and product liability insurance. The parties should also agree on the providing of insurance policies, both parties should have matching authenticated copies of the policies.

By principal the term of delivery (Incoterms) determines the need for the transportation insurance. The need and interest for the transportation insurance is naturally on the party that holds the risk of the goods during transportation and as the delivery term defines the bearer of the risk of the goods also the insurance burden is defined in the delivery terms. So for example, when using CIP or CIF delivery clauses the risk of the goods moves to the buyer already when the goods are loaded on to the vessel that performs the delivery, therefore the buyer should have an adequate insurance already for the transportation. In Company X the delivery clause is supplier specific, meaning that the delivery clause is negotiated with every supplier as an individual, therefore special attention needs to be given to insurances concerning transportation. (Pasanen, 2005: 366)

General third party insurance is part of managing risks in commercial transactions. It is important in commercial transactions which happen between the supplier and the buyer. Typically the buyer may demand the supplier to take the insurance to cover its solvency in case of any damages (e.g. delay in delivery, product flaw) caused to the buyer by the supplier. (Haapio et al, 2005: 342-349) The insurance is negotiated between the supplier and an insurance company. Depending on the insurance company, the general third party insurance covers bodily inju-

ries, property damages and financial damages which have occurred to the buyer's company because of the supplier's actions. It has to be checked from the suppliers insurance policy what it's general third party insurance covers as insurance companies are often keen to limit their liability for damages regarding financial damages as they are so hard to define beforehand and in a case of a substantial financial compensation it can become very costly for the insurance company. (Kettula, 2006)

Product liability insurance is meant to cover damages which occur because of the supplier's actions to third parties, for example customers. If a faulty product produced by the supplier for the buyer is responsible for causing damages to the buyer's customers the supplier can be hold responsible for this. Product liability insurance covers only bodily injuries and property damages, financial damages are left out of its compensation area. (Kettula, 2006)

The required characteristics of the goods and guarantee

The parties must define exactly what is wanted to be the characteristics of the goods which are purchased from the supplier by the buyer and the parties must be sure that they understand each other the same way. Packing, specifications, licences and quality are only a few of the characteristics that have to be agreed on. In many cases this is not a big problem as suppliers are chosen as subcontractors already for the quality they produce. Usually the packing instructions etc are given as an attachment to the order for the supplier and they are only referred to in the general agreement just to make clear that these instructions have to be followed. (Pasanen, 2005: 109) Many buyers demand a guarantee for the goods which they purchase, not only give the risk burden to the supplier if a fault is noticed in the product but also to be used as a deterrent for the supplier to make sure the goods are produced in accordance with the specifications etc. Guarantees are depended on the employment intention and the characteristics of the products purchased. It is important to notice that sometimes guarantees narrow the responsi-

bilities of the supplier if a defect is found in the goods. (Piksilä-Rantanen, 2006)

Consequences if a fault is detected

If a fault is found in the goods purchased, the buyer and the supplier both have different responsibilities and obligations according to either the contract or if nothing is defined in the contract then to the law. First of all the buyer has to inform the supplier that a defect has been found in reasonable time without any unnecessary delay. Then the supplier can either replace the defected goods free of charge as soon as possible, give a discount of the defected goods or if the supplier isn't able to compensate for the defected goods the buyer can call of the deal (in which case also the payment is returned to the buyer). The buyer can also hold the supplier responsible for the damages caused to the buyer if the product must be pulled out of the markets. It is important to define the responsibilities and obligations of the parties in a case of a defect because with clear instructions defects can be easily dealt with and cooperation between the buyer and the supplier can be protected and continued. (Piksilä-Rantanen, 2006)

Delivery inspection

It can be agreed that the buyer has a responsibility to inspect the goods as soon as reasonably possible for defects or quantity mistakes. Sometimes this is fairly difficult to do if the goods are, for example, delivered straight to a buyer's customer. In such cases, it should be made clear to the supplier that the delivery inspection might take more time than usual (if the buyer's customer notices a defect it informs the buyer and the buyer can mediate the findings to the supplier). Possible costs caused by the inspection should also be agreed on and if a defect or lack in quantity is noticed, the buyer has a responsibility to inform the supplier of them. (Piksilä-Rantanen, 2006)

Reduction of price

Due to the nature of the business in which Company X operates in, the company decided to include possible attributes that account for a reduction on the purchasing prices. Company X has substantial suppliers with whom yearly purchases account for a large amount of the purchasing budget on the buyer side but also on the suppliers' side and that is why reductions were seen as reasonable. The reductions aren't included in all the general agreements made with Company X's suppliers, only with suppliers that could potentially be accountable. The reductions can be agreed on differently with all the suppliers and can also be left out if the supplier sees them as impossible to incorporate to their way of doing business. The reduction amounts and percents are counted for by all the buyers in Company X and compared to the yearly purchases with all the suppliers.

Ownership, licences and confidentiality

For Company X it is especially important that the supplier knows that all the materials sent by the buyer, for the supplier to be able to produce the buyers products must be kept in possession of the buyer even though they are physically located in the suppliers premises. It is important to identify what is the material that should be kept confidential, to whom can this material be shown to, what happens if an offence of the confidentiality is found, how long the confidentiality lasts for after the contract has been terminated and so on. All these matters aren't important with all the suppliers but with some they have to be given special attention to, for example, if the supplier doesn't know the buyer by reputation from before. (Piksilä-Rantanen, 2006)

Social responsibility

As explained before in the textile industry section of the thesis, social responsibility issues are coming more and more important in the textile industry as customers want to know how and where the products they purchase are produced. In Company X the social responsibility ques-

tions are answered by obligating the supplier to follow the instruction regarding working conditions given by the International Labour Organization.

The durability, notice and termination of the contract

The durability of the contract has to be specified as to when the contract comes into force and is the contract held at stated intervals or is the contract valid for the time being. In a case of a notice given to the contract it has to be defined how the notice should be given (written or oral) and is there a need for a reason for the notice and how long the term of notice is. The possible situations in which the contract can be terminated are also important to state in the contract to clear any room for confusion, for example a substantial delay in delivery or a substantial defect in the goods can be seen as a reason to terminate the contract immediately. (Pasanen, 2005: 120)

Force Majeure

Force majeure is a common clause in contracts, which essentially frees one or both parties from liabilities when an extraordinary event beyond the control of the parties, such as flood, war, riot, which prevents one or both parties from fulfilling their obligations under the contract. Recently also the threat of terrorist attacks has been added to the list. Thus parties can freely agree on the content of the clause. The party under force majeure has to inform about the circumstances during the agreed period of time to be released from his/her liabilities e.g. in a case of delay in delivery (Pasanen 2005: 98). Parties are also entitled to agree on the consequences: whether to continue the contract as agreed or admit additional time or right to terminate the contract. Scandinavian trade laws use often the clause of hardship (which CISG does not know) to define what is meant with commercial impracticability (Haapio et al, 2005: 225).

Notifications regarding the contract

It is important to state in the contract that all the notifications regarding for example the termination of the contract or any alterations to the contract must be made in writing and sent to a certain address by e-mail, mail or fax. The parties must also agree how the receipt of the notification should be documented and how the alterations affect the contract. (Pasanen, 2005: 116-117)

Assignment of the contract

In long-term contracting relationship there are sometimes situations in which the assignment of the contract comes into question; if, for example, the supplier ends the production of a certain product and it is moved to another supplier by a subcontracting relationship. Then it is important to state that the buyer gives its consent to the assignment of the contract and that the same contract terms apply to this relationship as well. If such consent is given it is usually wanted to be in writing so it can be easily proven if necessary. (Pasanen, 2005: 114)

Waiving of rights, partial nullity and exhaustive declaration of intention

From a juridical point of view there are a few clauses that are recommended to be added to the contract just in case a dispute situation might inflict. These are in many cases called boilerplate clauses. The waiving of rights –clause means that if the buyer, for example, doesn't claim damages for a delay in delivery once, it cannot be seen as an alteration to the contract terms. Partial nullity means that if the contract is declared partially void, it doesn't mean that the whole contract is void. An exhaustive declaration of intention is done by both parties when they sign the contract as the contract renders all other negotiations or correspondence concerning the contract between the parties. (Piksilä-Rantanen, 2006)

Choice of law and disputes

A complex aspect in international contracts is the choice of law of certain national legal systems. This is important in the case of litigation when contracts are interpreted and possible gaps are fulfilled with the laws applied. Therefore it is important for contracting parties to be familiar with the law they choose to avoid negative surprises. This is closely tied to the reference of the court under jurisdiction. These two aspects define the recognition and enforcement of foreign judgments (Pasanen 2005: 82). Arbitration has been a typical method to solve disputes of international commercial transactions. With arbitration are meant proceedings to settle disputes outside court proceedings. There the mediating party is given power by the disputant parties to settle the dispute by making a finding. In practice arbitration is generally used as a substitute for judicial systems, particularly when the judicial processes are viewed as too slow, expensive or biased. Typically specialists in the field are used as arbitrators. Thus contracting parties may agree freely on the use of arbitrator (arbitration clause) (New York Convention 1958). Haapio et al 2005: 214)

Signatures place and date

The contract is ratified after giving the date and signature of the contracting parties. Attachments are to be enclosed to the contract to make sure both parties are aware of possible attachments and their binding force as well as the order of validity of documents. Also possible witnesses and power of attorneys are mentioned. (Piksilä-Rantanen, 2006)

3.4.1 Other matters to discuss when drawing up purchasing contracts in the textile industry

Intellectual Property Rights (IPR)

In the Finnish Legal system IPR is regulated in the field of copyrights (Tekijänoikeuslaki 8.7.1961/404), trade marks (Tavaramerkkilaki 10.1.1964/7), patents (Patenttilaki 15.12.1967/550), copyright of design

(Mallioikeus 12.3.1971/221) to mention some of the important ones in this case (FINLEX). The main principles of IPR law are the protection and defence of these rights through the right of veto (who and how is entitled to use the rights) in the case of commercial use (Pasanen 2005: 565). Sanctions for the breach of these rights typically are injunctions to use of e.g. particular trademark and compensations for damages. However, sometimes it can be really hard to determine the appropriate value of the compensation in terms of money. Thus amounts of compensations can vary greatly between different countries. It is important to consider whether to register (in the case of trademarks, patents and design copyrights) the items included in IPR in the national or the international level, since the registration in one country provides protection only in that particular country. Finnish firms, since Finland became a member of EU, belong to the sphere of influence of institution Community Trade Mark (CTM), which also has joined (2004) to the international registration system, Madrid Protocol. Registrations made under CMT are valid in all member states. (Pasanen 2005: 566-610, 614- 626) In contracts it is important to determine the right to use intellectual property rights, the extension of the rights, the period of validity of rights and the permissions to transfer the rights to third parties.

Prices

The contract price is sometimes difficult to determine. It is an important part of the profitability of the contract. Factors affecting to the price can be competition position of parties negotiating, the terms of quantity purchased, etc. Due to fluctuations of currency rates and transportation costs, the definition of a fixed price can be difficult in long term contracts. Also the level of risks (insurance payments) and taxes have their effects on purchasing prices. The feature freedom of contract gives parties the possibilities to agree on flexible pricing terms as well as renegotiate the prices in the circumstances of unreasonable high or low prices (Pasanen 2005: 112). In Company X, prices are negotiated with every

supplier at a time, and therefore, price lists are attached and approved by both contracting parties and are therefore a part of the contract.

Reclamation

According to the basic settings contracting parties are entitled to the assumed performance agreed in the contract – payment in kind. In other words, the supplier is entitled to the contract price of the goods sold as the buyer is entitled to goods ordered from the supplier. However, it is sometimes impossible to demand “assumed performance” (e.g. delivering the new product replacing the damaged one) due to concept of time or due to quality problems. This alternative can be eliminated from the terms of the contract just due to practical or legal factors, or being impossible to put into effect. If payment in kind is not suitable, following legal remedies can be used to achieve the initial goals of the contract (Kurkela, 2003: 59):

- 1) The buyers right to liquidated damages and (or)
- 2) To receive compensation for damages and (or)
- 3) To terminate the contract

If a legal remedy is requested reclamation should also be delivered for the supplier. A reclamation is a notice for the supplier that the goods, material or service purchased by the buyer is late from the agreed delivery time, is contrary to the contract or has a fault in it and a reclamation always incorporates a claim against the supplier to either compensate for the damages or a claim for the cancellation of the contract. (Haarala, 1996)) The main purpose of reclamation is to offer a possibility for a party to correct the possible defects in products or in performance. The secondary purpose is to minimize damages and prepare for compensation claims (Kurkela, 2003: 194). In other words reclamation is a breach of contract and every buyer has a right to reclaim if a breach of contract is detected. This right can only be lost if the reclamation isn't

done in the agreed way (for example by overlooking the agreed form or time frame for the reclamation). (Kurkela, 1981: 43-46)

4 Research design

The main motive for this research was a lack in an effective purchasing contract model in Company X. This lack has affected the commercial aspects of their operations and they feel they were being left behind in the textile subcontracting field as other major buyers already have contracts and they were in many cases a priority for the subcontractors. The aim of the research was to first identify the characteristics of the textile industry which affect subcontracting and then investigate the theoretical framework in which purchasing contracts operate in. Through this and through the empirical research the most important clauses of a purchasing contract was hoped to be found which could be used to decrease the risks of subcontracting and reclamations. Also a model purchasing contract was drawn as an end-result for Company X through this final thesis research.

I decided to perform the empirical research part of my thesis through interviews which were sent by e-mail to the interviewees on the 15th of March (Appendix 1). This seemed to be the most natural way as with interviews, in-depth information regarding the topic can be acquired and this was the point from the beginning with my thesis. (Eskola & Saarinen, 1998; 46-48) The decision to send the interviews by e-mail was done not only due to lack of time but also because seeing the immediate reactions of the interviewees to the questions didn't seem necessary regarding the topic. E-mail questions also gave the interviewees more room to think about the questions and as they all are very busy they had the chance to answer the questions when they have the time. In addition to the e-mails, I also interviewed the answerers face-to-face on the 21st of March to give them a chance to explain their answers in more detail and also to be able to add points which they had regarding the topic. In the face-to-face interviews, I also cleared any confusion that I might have had with the answers. However, the answers gotten

from the e-mail interview were the most important source for the empirical study.

All the interviewees work in different positions in Company X and look at purchasing contracts from different points of view. One is the production manager of Company X, she is in charge of the all the production activities that happen in Company X and holds all the ropes. She ultimately decides where to produce what and when. Therefore the general introduction of purchasing contracts would influence her job the most. The second interviewee is a buyer with experience from the same line of work from different companies and she is also in charge of import logistics within Company X. I felt that she could mirror her past experiences with purchasing contracts from different companies and use them as reference in the interview questions. The third interviewee is also a buyer and she has gone through a purchasing contract negotiation process with one of Company X's main suppliers. Because of this recent experience she had fresh viewpoints as to where subcontracting as a trend in going in the textile industry and what could be the important clauses of the purchasing contract to help keep up with the recent developments.

I divided the questions into four themes. These themes look at the research question from different angles. The themes are based on the theoretical concepts and framework which has been discussed in the earlier parts of the thesis. General information regarding the current situation of Company X was gotten from the first group of questions. This information was compared to the theory which had already been examined in the earlier parts of the thesis. In the second group of questions, the actual practical side of subcontracting in the textile industry was examined. The third theme was meant to open up the risks of subcontracting in the textile industry furthermore than in the theory parts. And in the fourth theme suggestions and explanations for the important

clauses of the purchasing contract were tried to achieve. The four different themes of the interview are:

- general information of the current situation of Company X
- subcontracting in the textile industry
- subcontracting risks; being late, quality problems, IPR violations and ethicality
- purchasing contracts

All the themes are as important as the next one and the answers gotten from the interviews were analyzed as a theme rather than on a question to question type of analysis. The themes were found counter parts from the theoretical part of the thesis and these two were mirrored to each other. The interviewees all felt fairly similarly about the subject and this made the analysis easier on the other hand but also it was difficult to find the most important points from the answers due to this like-mindedness. Every time a difference in the answers was found, it was highlighted in some way. My own experience as a member of the work community confirms to some extent the reliability of the results gotten from the research as I deal with these same issues and situations daily. However, these experiences also might have caused a certain amount of stocktaking in the analysis because it was hard to just stick to the interviewees answers when one has some practical experience regarding the subject as well. There is also the risk of generalization which affects the validity of the thesis; the answers of the interviewees can't be taken as universal truths about the textile industry even though they are congruent with the theories of the subject. This needs to be taken into consideration when making the final conclusions.

5 Interview questions and analysis

5.1 General information of the current situation of the company

How much is subcontracting used in Company X and how long has subcontracting been used in Company X?

The interviewees stated that subcontracting is the main way to operate in the textile industry today and that subcontracting is used a lot in Company X as well. The number is increasing all the time. The reason behind this is the fact that it is no longer financially profitable to do all operations within the company due to increasing competition and increasing costs.

Company X has used subcontracting already from the 1950's and will continue to use it in the future.

Where are Company X's products produced? Do subcontractors in different countries vary from each other?

Most of Company X's products are produced in Europe but a shift has been seen here as well; some products are no longer available in Europe or are too expensive to produce in Europe and that is why some of Company X's products are also produced in the Far-East which in return brings more and different kinds of risks to subcontracting.

The biggest difference in subcontracting in Europe and in the Far-East is the cultural differences that occur. The subcontractors of Company X are usually small or medium sized companies although there are a few bigger companies as well.

Why was subcontracting started in Company X?

The first reason behind the starting of subcontracting was the lack of infrastructure inside the company; Company X had a printing mill but didn't have the adequate finishing machines to do all the necessary finishings to the fabrics printed. Therefore the only option at this point was to outsource the finishing operations. The necessary machines have now been already purchased to the company but from there on out, subcontracting became a constant part of production in Company X.

What Company X's products are subcontracted and are all the subcontractors the same (are there different ways of subcontracting used in Company X, OPT, SOD etc)?

Subcontracting has spread to all production operations that are done at the moment in Company X. All three lines use subcontracting and also different ways of subcontracting are used, mostly OPT and SOD.

Analysis of the general information of the current situation of the company

As stated earlier in the theoretical part of the thesis, subcontracting is seen as the key for survivor for the textile industry as a whole, especially in Europe. The same can be seen from the answers that were gotten from the interviews; without subcontracting, Company X wouldn't be able to operate cost-effectively on such a large scale in interior design, clothing and bags. Company X has dealt with the same modernization process as have many other European textile companies; the amount of employees has gone down while production has become more cost-effective through a modernization processes. Some production operations which were before done in-house have been outsourced and only the core-competences of the company have been left as in-house operations. This is the trend in many other European textile companies as well, as stated in the theoretical part of the thesis. One example of the core competencies for Company X is, for example, printing. The com-

pany still has a printing mill in Finland and this printing mill is seen as a major asset to the company and the know-how and skills that are connected to the printing are wanted to be kept as in-house operations.

The network that is referred to by the interviewees is also recognizable part of the European subcontracting in the textile industry; as stated in the theoretical part, subcontracting companies are usually concentrated in particular regions and they also often work together.

5.2 Subcontracting in the textile industry

What kind of industry specific characteristics does the textile industry have? What needs to be taken into consideration when subcontracting in the textile industry?

According to the interviews a characteristic that is found in the textile industry subcontracting is that the industry is highly networked in Europe and in Asia and co-operation works when every subcontractor is specialized in its own expertise field. This lessens competition between subcontractors and also helps the process of finding a new subcontractor.

Issues that have to be taken into consideration are risks; a subcontractor might ruin the material or violations against the company's IPR related to the designs.

The benefits of subcontracting in the textile industry? Does different ways of subcontracting have different benefits?

Benefits that can be seen as acquired from subcontracting are according to the interviewees, flexibility and the small investments that the prime contractor (Company X) has to make. Also the expertise that can be found from the subcontracting companies is a benefit that the interviewees see.

Different subcontracting ways have different kinds of benefits:

OPT: when Company X acquires the materials and the requisites, they can use their expertise in this field which is better than in the sewing companies and also in most cases the sewing companies don't have enough resources to fund the acquisition of materials and requisites. Also Company X has a bigger network from where to acquire the requisites and materials and also when this is done by Company X, the requisites and materials can be tested for potential faults and also for the suitability for the product in question (colours etc). A designer can find new materials to use more easily than a subcontractor that is producing ready-made products as the designer knows what he/she is looking for.

SOD: when buying ready-made products, they require less follow up although it is more difficult to change the orders that have already been made to the supplier

***The risks and pit falls of subcontracting in the textile industry?
Does different ways of subcontracting have different risks and pit-falls?***

According to the interviewees, subcontracting in the textile industry has also its risks; if the subcontractor files for bankruptcy, Company X might lose all of its materials which are in the subcontractor's warehouse. Also intellectual property rights violations are seen as a risk in Company X where the designs are seen as one of the most valuable assets of the company. On a more practical note, there is always the risk that the subcontractor is late which might lead to substantial financial losses. Also there is the risk that the subcontractor's quality isn't on the same level as Company X's or that the subcontractor ruins Company X's material.

Also in different ways of subcontracting some pitfalls are seen:

OPT: when buying only sewing, the buyer has to keep watch also that the materials and requisites are sent to the subcontractor at the right time and that the quantity is enough.

Analysis of subcontracting in the textile industry

The subcontracting companies which Company X co-operates with are mostly small and medium sized companies and most of the subcontracting is happening in Europe but also a movement is taking place towards the Far-East, not only because of cheaper prices but also due to lack of infrastructure which would be meaningful for the subcontracting operations. As stated in the theoretical part, a similar situation can be seen in many other European textile companies; many European companies, especially operating in the more high-class more expensive items niche still want to keep production in Europe. However, almost all European subcontracting is taking place in the most inexpensive countries in Europe: Estonia, Lithuania, Ukraine etc.

Company X has subcontracted since the 1950's which is normal for a Finnish textile company as Finnish companies were one of the first to start subcontracting their operations in Europe. As explained by the interviewees, Company X hasn't noticed a significant change in the amount of subcontracting operations shifting to the Far-East. This is also due to the image and mode of action which Company X has wanted to keep up; Company X feels that the Far-Eastern subcontractors can't produce the same quality products that Europeans can, cultural differences are bigger which complicates co-operation and also the risk of ethical problems and IPR related problems are bigger in the Far-East than in Europe. All in all, many more and bigger risks might arise if more of Company X's subcontracting operations were moved to the Far-East. The movement might inflict more problems with quality and delivery times as well.

According to the interviewees, the biggest reason behind the start of subcontracting in Company X was the lack of infrastructure in Finland but also other factors played a part in the decision to subcontract; especially nowadays it isn't financially profitable to produce products in Finland due to increasing salaries and lack of employees. This can also be seen from the yearly study that is published by Tekstiili- ja Vaatetusalan ry. Also when Company X wanted to expand their product range it was wiser to find the real experts outside the company rather than try to produce everything by themselves. This helped also to insure that the quality of the product was up to scratch. This is one of the major motives for subcontracting as explained in the theoretical part of the thesis. However, whenever possible Company X will use a Finnish producer rather than an abroad subcontractor as this is better not only for the image of the company but also because co-operation with Finnish subcontractors is always easier than with abroad ones. This co-operation also helps the Finnish subcontractors to survive. Other motives and benefits that can be gotten from subcontracting were according to the interviewees, flexibility and small initial investments from the prime contractor. These are also important motives for subcontracting in the other European textile companies.

Company X uses different ways in subcontracting; OPT and SOD mostly. They are seen as the most cost-effective subcontracting methods and they have been working well for Company X in the past and also they are seen as the future ways of subcontracting. Almost all operations of production are subcontracted in Company X; from the raw materials to the ready-made articles. As explained in the theoretical part of the thesis, according to the European Union, OPT subcontracting is one of the most popular methods in textile industry subcontracting.

5.3 Subcontracting risks; being late, quality problems, IPR violations and ethicality

What kind of problems has subcontractors tardiness related situations caused Company X?

The interviewees listed quite a few problems that have occurred when subcontractor's deliveries have been late; the reputation of Company X as a supplier has felt a bump when Company X's own customers haven't got their ordered products. This has also meant a drop in supplier analysis that Company X's customers make for their suppliers and leaves Company X with less potential customers. Company X has had to pay penalties for lateness as Company X's customers have their own purchasing contracts which have penalty clauses. Also extensions of time for payment have had to be made.

On a more general note, the reputation of Company X has been damaged when some products have been advertised and then the products have not been in stores when customers have gone after them according to the ad. This has also meant that Company X has paid for ads that haven't been financially profitable for the company.

Company X has also had to pay extra for deliveries to their own customers and shops if the products have been late when coming from the subcontractor.

When can the subcontractor be seen as being late and if this has happened what has been done in a situation such as this? Has subcontractors' tardiness related issues effected Company X's financial situation, image or something similar?

The interviewees see the subcontractor being late when it hasn't informed Company X before the delivery date that the delivery will be late and when approval wasn't been given from Company X that the delivery can be late.

If the supplier's lateness has been caused by a humane mistake, no measures have been made if it hasn't been seen as intentional or drastic. But if the lateness is caused by something else or it affects Company X image etc, discounts have been asked for and gotten. When the tardiness has been drastic, substantial discounts have been asked for. In some cases quality and lateness have gone hand to hand; if a quality fault has been detected in the first delivery patch, it has affected the delivery time of the next patch if the supplier has had to fix all the faults in the second patch.

The reputation of Company X as a supplier isn't very strong due to subcontractors' tardiness related issues. However, as Company X also uses OPT subcontracting, there have been many cases where the lateness of the delivery has been caused by Company X's own problems with providing the subcontractor with the materials and/or requisites. In these cases, no discounts or other compensations have been asked for. In some cases, Company X can be seen as the party that should be giving compensations for loss of money and time for the subcontractors; if Company X has reserved capacity from a sewing company and then fails to deliver the materials and requisites; the subcontractor is left with no work for the time.

What kind of problems has occurred with subcontractors' quality? Has subcontractors' quality related issues effected Company X's financial situation, image or something similar?

The interviewees also listed quite a few problems that have occurred with quality; there have been problems with colour bleeding, shrinking, holes in fabrics, askew fabrics, the sewing has been wrong etc. The same problems have occurred with OPT subcontracting and also with SOD subcontracting.

Some production patches have had to be pulled out from the markets altogether and this has meant loss of sales and also a bump in Company X's reputation. These patches have, in most cases, been one time orders from faraway suppliers.

Company X aims to always test and approve the subcontractors' quality before production and if the quality isn't up to Company X's standards, the whole production and product is cancelled.

What is quality according to Company X and when is this achieved in subcontracting? How can purchasing contracts be used as a mean to better/maintain Company X's quality?

According to the interviewees, Company X's quality is achieved when the product or material is compatible with the standards and specifications that are given by Company X to the supplier. Quality is different with every supplier but it still should be consistent throughout the collections and with the image of Company X.

However, one of the interviewees, stated that it is sometimes hard to achieve Company X's quality due to the insufficient and unclear organization scheme; if a fault is found in the sewing model sent to the sewing company, it is hard to find the person (production manager, collection manager, the designer or the model designer?) who has the authority to make the decision to change the model.

The interviewees also stated that quality can be bettered/maintained by purchasing contracts by documentation; when the quality standards and specifications are documented efficiently and unambiguously as an appendix of the contract then problems with quality are usually lessened. According to one of the interviewees, this is normal practice in many textile companies. Also a clause should be added to the contract that the product is approved for production after certain test etc.

Has any IPR violations been made against Company X? If yes, what kind have they been and how have they affected Company X?

According to the interviewees, IPR violations have been made against Company X. The interviewees see these violations as a double-edged sword; on the other hand, they make the brand weaker, when a customer can buy the same products for less, but on the other hand it makes the image of the company more interesting; “if the products are even copied, they must be valuable not only according to the price but also as a fashion statement!”

How are the intellectual property rights of Company X controlled?

One of the interviewees knew that the company uses the services provided by an expert office to control the immaterial property rights of Company X. However, she added that IPR's should also be taken into consideration when drawing and signing up purchasing contracts.

Has Company X ever had any problems with the ethicality of subcontracting? If yes, how have these problems affected the company?

To this date Company X hasn't had any problems with the ethicality of subcontracting but the interviewees also stated that as a listed company that is fairly often in the public eye, Company X has to be alert at all times of such potential problems.

Who and how is Company X's subcontracting ethicality supervised?

The ethicality of subcontracting in Company X is supervised the buyers and by purchasing and other types of contracts according to the interviewees. The buyers interview and sometimes visit the suppliers to see the conditions of the subcontractor before beginning the co-operation. Also a clause is added into the purchasing contract that obligates the supplier to follow the ILO (International Labor Organization) instructions.

How can the risks of subcontracting be controlled? How can the number of reclamations which are caused by subcontracting be decreased?

According to the interviewees subcontracting related risks can be controlled by good purchasing contracts and by following the purchasing markets so that Company X isn't in the "mercy" of the subcontractors which are used at the moment. Also the instructions that are given to the suppliers should be unambiguous and uniform. Visits to the factory during production also help to decrease the risks and reclamations. However, the bigger picture is hard to obtain in Company X, according to one of the interviewees, as the production output is so enormous that when one reclamation comes, the buyers rarely know how vast the fault has been. Therefore, the interviewee wishes for better control of the production as a whole and hopes that every time any cause for feedback is known, the feedback is actually given to the subcontractor.

Analysis of subcontracting risks; being late, quality problems, IPR violations and ethicality

The risks and pitfalls of subcontracting are according to the interviewees, quality related, deliveries being late and IPR violations related risks. IPR came up as a risk due to past experiences Company X has had with coping intellectual properties. Ethicality hasn't been a risk Company X has had to face before, but it is realized that the risk is always present while subcontracting abroad. These are the most common risks of subcontracting in the textile industry.

When a supplier is late the problem in many cases multiplies as supply chains have become longer in the recent years. Every customer has their own customers for which they are responsible for. This was already stated in the theoretical part of the thesis and this theory was proven correct by the interviewees; Company X has experienced lost in sales and in image in situations when suppliers have been late. Sub-

contractors being late have also affected Company X's marketing and efficiency as a company.

When a subcontractor has been late, Company X has demanded discounts on price and also expedited deliveries which are according to the theory part, standard procedure.

Company X has according to the interviewees experienced problems with quality such as askew fabrics and colour bleeding. In most cases these are humane mistakes which have been corrected already before production. But unfortunately, there have been situations in which Company X has had to pull out an entire production patch because of fault that were found in the products. These types of situations affect the image Company X has and this is also the case in many other textile companies around the world as is stated in 1.4.2 "Risks of subcontracting". Quality according to the theory part is a compromise which concurs with the interviewees answers; even though specifications are given to the subcontractors it is always in the hands of the suppliers to produce the goods.

IPR violations are fairly common in especially the textile industry sector which produces products according to their company specific instructions and guidelines; these include also the designs and sewing instructions as stated already in the theory part of the thesis. According to the interviewees Company X has also experienced violations against their IPR's but fortunately to this date the number of these violations haven't been too substantial. Company X does see that the violations hurt their image and might even hurt them financially, although this hasn't been documented but then again they also see it as positive to a certain point which was not introduced as an effect of IPR violations in the theory part.

As already said, Company X hasn't to this date had problems with the ethicality of their subcontracting but this risk is seen as a very potential one, especially as some production is forced to be moved to the Far-East almost all the time. The findings of the interviews correspond with the theory part; more attention is given to this risk all the time in the textile industry and it is also seen as the biggest growing risk of subcontracting. It is the companies own responsibility to supervise their ethicality and also with wise decisions the ethicality of Company X might never have to be questioned.

5.4 Purchasing contracts

Why should purchasing contracts be made?

All the interviewees stated that purchasing contracts help the buyers' jobs and also that subcontracting risks can be avoided or at least lessened. Contracts tell the buyers' what to do in problem situations and in the long run purchasing strategies can be developed through contracts. Also the same purchasing skills can be spread wider to all the buyers' in Company X.

What benefits can you gain from purchasing contracts in your own line of work? What benefits can Company X gain from purchasing contracts?

The interviewees all felt that purchasing contracts can help them do their job and also lessen the number of reclamations and subcontractors tardiness related problems. For Company X as a whole, the interviewees felt that the purchasing power of the company can be better used and the certainty of delivery and quality will also get better. Purchasing contracts can also bring a unified practice for all reclamation etc cases. The interviewees also felt that cases of IPR violations and suppliers advertising with Company X's name would also decrease.

What disadvantages can you see purchasing contracts bringing to your line of work? What disadvantages can purchasing contracts bring to Company X?

The disadvantages that can be seen brought by purchasing contracts are according to the interviewees;

- the time it takes to develop a contract that suits all the ways of subcontracting used in Company X
- with many of the subcontractors, the co-operation has lasted for many years (10-20 years) and a very strict contract might scare them away
- Also by a strict contract a rise in prices might occur as the subcontractors might want to protect themselves from penalties etc
- with some of the subcontractors a verbal agreement has been made along time ago that they aren't allowed to have their own collections and also that they aren't allowed to produce products to Company X's competitors and if a strict contract is drawn with them and Company X decides not to continue the co-operation, the subcontractors would be left without any work and might be forced to close shop. According to one of the interviewee this is an ethical problem that might arise from purchasing contracts.
- Many of the subcontractors are small or medium sized businesses that aren't used to reading juridical texts and might not be completely clear of what they are getting into if they sign the contract. In the long run this can develop to be a problem.
- For some of the subcontractors, however, Company X is a fairly small customer and as they have their own other contracts with other clients as well, if the contract Company X will start to use is too strict, they might not want to continue the co-operation if it could hurt their other bigger clients and expose them to bigger penalties.

What should the purchasing contract contain? What matters need to be taken into consideration when drawing up a purchasing contract so that the risks of subcontracting could be decreased? What are the most critical parts of a purchasing contract?

The interviewees felt that the most important points to take into consideration when drawing up a purchasing contract are; general and all-inclusive terms of co-operation and also penalties are felt as one of the important parts of a efficient contract. Penalties are seen as one of the best ways to intimidate the subcontractors so that they understand the importance of deliveries happening in due time and that the quality has to be up to Company X's standards. Also concealment, advertising with Company X's name and IPR related issues should be dealt with in the contract and unambiguous clauses should be added to make these issues clear for both parties. One important part of the contract is also the right to use 3rd party subcontractors in the production. One of the interviewees felt that this should be clearly stated whether or not it is acceptable for Company X. However, this is one clause that has to be dealt with on a supplier to supplier basis as the subcontractors are in very different circumstances comparing to each other; some might have all the equipment etc needed to produce the whole production at their own factory, some might be forced to use outside subcontractors to be able to comply Company X's requirements, for example, quality.

Regarding only OPT subcontracting, an important point to keep in mind according to the interviewees is that tardiness related clauses should be stretched so that they also take into consideration the situations in which Company X is late for sending the materials to the subcontractor. This way an atmosphere where it only feels that the subcontractor should always be on time regardless how late Company X is, is avoided.

Related to tardiness in general, despite the way of subcontracting, a clause which states when the subcontractor is seen as being late is felt as an important part of the contract. Also in some cases when the subcontractor has been late, Company X has demanded that the products have to be sent by air mail and therefore also a clause which would state clearly which situations require the use of air mail (on the suppliers expense) should be included in the contract.

Clear instructions for how and in which situation should reclamation be done, is also seen as an important point of the contract. At the moment the reclamation process is very varied in Company X and through the implementation of purchasing contract, some clearness is hoped to be achieved to this process. Also linked to the same matter, clear instruction for who is responsible and liable for the payment when it comes to outclearances especially with products coming from the Far-East and if products are faulty who pays for the resending of the products.

Analysis of purchasing contracts

The interviewees felt that purchasing contracts could work as an intimidation tool to keep subcontractors under check more easily and with this lessen the number of reclamations and violations against IPR. Also an important part that rose from the interviewees' answers was the fact that as the number of subcontractors is ever-growing in Company X, a unified system for reclamations and business in general as well would be useful. The same is explained in the first chapter on purchasing contracts in the theoretical part of the thesis. All the answerers also felt that purchasing contracts could help them do their job and as explained in Helena Haapio's article; an effective purchasing contract can benefit all operators inside a company.

Also disadvantages were listed by the interviewees, which weren't in specific dealt with in the theoretical part of the thesis. This is a major

point which has to be taken into consideration when making the purchasing contracts. One point that was introduced in the theoretical part was the decrease of control purchasing contracts might cause the purchasing operations, this was not mentioned as one of the biggest downsides of purchasing contracts by the interviewees. The interviewees, especially one of them, concentrated on how very strict purchasing clauses might affect the image of Company X and also how strict clauses might affect the prices of the subcontractors. Also, purchasing contracts might make business a lot harder between old subcontractors that aren't used to reading legal texts; a too juridical contract might scare the old and smaller subcontractors. However, the bigger subcontractors that are used in Company X are more used to reading legal texts as they are very common when operating with other big clients.

The most critical parts and points of purchasing contracts according to the interviewees are quality related clauses, delivery time related clauses and also other risk related clauses that might occur when subcontracting. It is very important for Company X that its intellectual property rights are respected as the company is very design oriented and these designs are exclusive to the company. The interviewees stated that high quality is a major factor in Company X's image and that this image should be maintained by purchasing contracts. All of these points are also highlighted in literature dealing with purchasing contracts. Penalties were also seen as a central part of purchasing contracts. Social responsibility related clauses were mentioned in the interviewees when asked about the ethicality of Company X's subcontracting. All of these points were taken into consideration while drawing up the purchasing contract model for Company X.

Even though delivery terms and shifts of cost, risk and title were introduced in the theoretical part as an important part of the purchasing contract, this wasn't however, one point that the interviewees felt that needed to be highlighted. The interviewees stated that big problems

with subcontractors are rather uncommon and that if some problems have occurred they have been fairly easily resolved with the subcontractor due to long relationships and both parties willingness to continue the co-operation. This, I believe, is the reason behind the lack of highlighting in terms of delivery and shift of cost, risk and title. Also insurances weren't mentioned at all in the interviews, although from a theoretical point of view they are seen as an important part of purchasing contracts and issues that have to be dealt with in contracts. This I presume is caused by the lack of information that Company X has relating to insurances at the moment. However, there is a team working on resolving insurance related issues within the company at the moment. Guarantees were not discussed in the interviews, this possible result from the fact that textile goods and especially Company X's products aren't easily given a guarantee. Who can give a certain period of time that a shirt or an oven mitten will last for in the same condition it was bought? Reduction on prices weren't also mentioned in the interviews, possibly because they are seen as too supplier concentrated issues that have to be dealt with in the contracts. It is impossible to give a constant percentage that could be applied to all products and materials Company X purchases. Force majeure clauses were left out of the interviews as well, possible due to the fact that the interviewees saw them as self-evident parts of a purchasing contract.

6 Conclusions

Company X is a textile industry company which was established already in the 1950. Subcontracting has been used from the start as a production method and because of this a need for a purchasing contract model was obvious as the risks of subcontracting have affected Company X's operations increasingly from the beginning. In the recent years these risks have become more substantial and nowadays Company X can't keep up with the competition anymore coming from its competitors in the subcontracting field. That is why through this research the identification of the most important clauses for controlling the risks of subcontracting and reclamations caused by them were a goal to be reached. Also an objective was to draw up a model purchasing contract for Company X keeping in mind the findings of this thesis. However, the model contract was wanted to be kept confidential and that is why it is only referred to in the thesis and not an appendix of it. Interviews were chosen as a research method because they are an effective way to get in-depth information regarding the subject.

The risks of subcontracting are obvious; they become evident from the theory part of the thesis and are given a practical framework by the empirical study. However, for a company to survive in the textile industry subcontracting is crucial, without subcontracting there is little hope for any European textile industry to survive in the ever-growing competition which will increase in a few years time even more when China and other Eastern giants of the textile industry will have free access to the European textile markets. With that said, European and Finnish textile companies are forced to take these risks.

However, these risks can be controlled. There are different ways to control risks, whether to divide the risks or avoid them altogether, the main idea is to accept them and decide on a level of tolerance for the sub-

contracting risks. Avoiding risks might sound like the best option but this might not be the case in every situation. By recognizing risks, a textile company can prepare itself much better for subcontracting.

For Company X, an efficient way to control risks is to prevent and decrease them from the very beginning. An important part of subcontracting risk prevention is to build sustainable, long-lasting and trust-based relationships with the current subcontractors. Only by mutual trust can a relationship such as this sustain. Some subcontractors have been working with Company X for many years and these relationships should be cherished. Possible co-operations on development of the subcontracting operations are seen as a good way to strengthen the relationship. An expansion of the subcontracting relationship could be, for example, the development of a new raw material only for Company X's use.

As all the interviewees felt that the more subcontracting is shifted to the Far-East the more the risks of subcontracting are present, thus an efficient way to prevent these risks is not to start broad subcontracting actions in the Far-East at all. Till this date, Company X has tried to operate only in European subcontracting market; however this might not be possible in the future. In a situation as this, Company X has to choose one or two options: either to raise prices so that all the expenses that come from subcontracting in Europe are covered or then to start production in less-developed countries. The latter option requires an efficient subcontracting controlling systems present in the area, where the subcontracting operations are done from Company X.

With old suppliers trust is the key factor of the relationship; it should be cherished to the fullest. But when a new subcontractor is attached to the supply chain, Company X should examine their possibilities carefully and as stated in the interviews, keep track of what is going on in the subcontracting field in which Company X operates in. As a strategy,

obtaining new subcontractors for Company X would be wise as it would make Company X's purchasing as a whole more dynamic and flexible.

When the network of subcontractors gets wider so should the contract base; if a suitable subcontractor is found, the first thing that should be covered is the signing of a purchasing contract. With new subcontractors a trust-based relationship has not yet been founded and therefore it is important to agree on all the important factors affecting the trade in writing. This is the way a trusting relationship is formed in the future. Also the legal framework of the purchasing contracts should be taken into consideration, as if nothing else is agreed on; it is the supplier's country's law that will be applicable to the contract.

With the content of the purchasing contract all the above risks can be covered by stating clearly and unambiguously in the clauses:

- **when should the delivery take place and when is the supplier been seen as late**
- **quality related issues should be covered and also attachments of specifications agreed should be inserted into the contract**
- **intellectual property rights should be agreed on and explained to all parties what is meant by them and what is seen as intellectual property**
- **which ethical rules and legislations should be followed between the co-operation**

These points were also taken into consideration when the model purchasing contract was written for Company X.

All of these clauses can be emphasized by the incorporation of penalties. With penalties, as stated by both the interviewees and the theoretical part of the thesis, a certain amount of intimidation and emphasis can be given to the agreed matter and no room for misinterpretation is left. Thus it can be said that through clear instructions and penalties a pur-

chasing contract can be used as a tool for managing risks of subcontracting and decreasing the number of reclamations.

A finding that wasn't introduced in much detail in the theory part but is still a very important fact to consider when making the model purchasing contract for Company X, was the disadvantages of purchasing contracts that the interviewees listed. It can be suggested that all purchasing contracts should be done on a supplier to supplier basis in Company X so that the differences which are paramount and obvious could be taken into consideration. If general purchasing clauses are given to all the subcontractors for signing, there is the risk present that either the subcontractor won't and/or doesn't want to understand the legal texts and therefore decides to rather opt out of the co-operation relationship to save its back. The subcontractor might also be willing to raise its prices so that they would cover the possible penalties that might be inflicted by the contract at some point in time. This is a decision that has to be made internally in Company X. The benefits and pitfalls of general purchasing clauses should be evaluated. After this a decision should be made whether to include all the subcontractors in the general purchasing contracts circle which would be the optimal situation as it would make the contract base homogeneous or rather to leave some smaller subcontractors out of the circle so that they won't be forced to end the co-operation or raise prices in fear of penalties.

All in all purchasing contracts are the future and present way to control subcontracting risks and Company X should follow the current trend so that it won't be exposed to the risks coming from not only the subcontractors side but also from its own clients. When a purchasing contract is drawn up with the most important risks in mind, it will work as an effective tool for decreasing and deleting these risks altogether. On the bigger picture well made and managed purchasing contracts could help and leave room for Company X to concentrate on the core competences of the company; top design and better quality than its competi-

tors. This would help improve Company X's image as a whole and also help improve the reputation of a weak supplier in its own customers' eyes.

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Appendix 1

Interview questions

How much is subcontracting used in Company X and how long has subcontracting been used in Company X?

Where are Company X's products produced? Do subcontractors in different countries vary from each other?

Why was subcontracting started in Company X?

What Company X's products are subcontracted and are all the subcontractors the same (are there different ways of subcontracting used in Company X, OPT, SOD etc)?

What kind of industry specific characteristics does the textile industry have? What needs to be taken into consideration when subcontracting in the textile industry?

The benefits of subcontracting in the textile industry? Does different ways of subcontracting have different benefits?

The risks and pit falls of subcontracting in the textile industry? Does different ways of subcontracting have different risks and pitfalls?

What kind of problems has subcontractors tardiness related situations caused Company X?

When can the subcontractor be seen as being late and if this has happened what has been done in a situation such as this? Has subcontractors' tardiness related issues effected Company X's financial situation, image or something similar?

What kind of problems has occurred with subcontractors' quality? Has subcontractors' quality related issues effected Company X's financial situation, image or something similar?

What is quality according to Company X and when is this achieved in subcontracting? How can purchasing contracts be used as a mean to better/maintain Company X's quality?

Has any IPR violations been made against Company X? If yes, what kind have they been and how have they affected Company X?

How are the intellectual property rights of Company X controlled?

Has Company X ever had any problems with the ethicality of subcontracting? If yes, how have these problems affected the company?

Who and how is Company X's subcontracting ethicality supervised?

How can the risks of subcontracting be controlled? How can the number of reclamations which are caused by subcontracting be decreased?

Why should purchasing contracts be made?

What benefits can you gain from purchasing contracts in your own line of work? What benefits can Company X gain from purchasing contracts?

What disadvantages can you see purchasing contracts bringing to your line of work? What disadvantages can purchasing contracts bring to Company X?

What should the purchasing contract contain? What matters need to be taken into consideration when drawing up a purchasing contract so that the risks of subcontracting could be decreased? What are the most critical parts of a purchasing contract?