Minority Business Case Study Series: Greater China Industries

The Consulting and Business Development Center and the Global Business Center at the University of Washington's Foster School of Business are collaborating with faculty from Historically Black Colleges and Universities and Minority Serving Institutions to publish a series of case studies focused on minority-owned businesses. These cases are meant to be used in business school classes and are available from the Foster School of Business. Funding support for these case studies also comes from the Minority Business Hall of Fame and Museum and the US Department of Education.

Greater China Industries

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"Never Give Up Easily" is the motto behind the success of Ben Zhang, founder and CEO of Greater China Industries, Inc. You can always see confident smiles from this business entrepreneur in the globalization era. With Ben's open and transparent leadership, Greater China experienced continuous sales increases from its founding in 1995 to 2015. However, in early 2015 Alibaba Group Holding Limited, the Chinese business-to-business (B2B) e-commerce giant, launched its IPO in the US, bringing a significant new competitor to Greater China's profitability.

"The company experienced sharp declines of sales," says Mel Cutter, Greater China's sales manager, which resulted in a decline in the company's gross profit from approximately 30% to less than 20% of sales during the first six to seven months following Alibaba's IPO. Mel believes that Alibaba is dis-intermediating the relationship between OEMs (original equipment manufacturers) and end customers by putting all of the information about outsourcing suppliers online together. "Although it initially attempted to assist global supply chain management and make it more transparent, it is indeed changing the way people do business globally," says Cutter.

Ben and his team are looking to develop a strategic response to the disintermediation strategy of Alibaba and he's asked a team of consultants to assist in developing this response. Based on the company's historic performance, Ben is confident about its vision and prospect. However, he recognizes that these issues must be analyzed and resolved: How did the Alibaba IPO affect the sales of Greater China? What strategies can Greater China use to mitigate the downturn of its profits? What other strategic "over the horizon" challenges will Greater China face and what strategies can they adopt to confront those challenges? What will Greater China end up with by following these new proposed strategies?

Background

Greater China was founded in January of 1995 by Ben Zhang in Seattle, Washington, because of its proximate location to China, while Ben was still taking his last business course at the University of Washington. Starting with nothing more than a small number of Chinese manufactured items at a trade show, Ben won the business of a distributor for a major west coast bank, earning orders for a quarter million pieces of seven different items. During Greater China's history the company has weathered two recessions and continues to thrive as a leading supplier in the Promotional and Consumer Product industries. Ben attributes this success and growth to a "customer first" philosophy: support client needs while continually nurturing long term, win-win import partnerships. Greater China delivers not only products, but also services such as consulting. The company is providing practical and creative solutions to client needs, evidenced by their innovative marketing, 30-day product guarantee, product safety testing protocol, CPSIA compliance leadership, and logistical expertise.

Ben Zhang arrived in the United States with just $330 in his pocket as a student in 1989. He holds a degree in economics from the University of Washington, an MBA from Cornell University in New York and Queen's University in Canada, and graduated from the Harvard Business School OPM program.

Nearly 20 years after the company's founding, it continues to experience significant growth and success, thanks in part to many loyal clients. Greater China has been on Promo Marketing Magazine's Top Supplier list since 2009. Ben attributes the company's success to his employees, who have voted Greater China a Counselor Magazine "Best Place to Work" every year since 2008. Headquartered in Bellevue, Washington, the company also has an office in Shanghai with 22 employees on the ground working remotely throughout China. Ben has been awarded the University of Washington Foster School of Business's Asian Business Leadership Award as well as City University's prestigious Global Innovator Award for his multi-cultural business success.[1]

Greater China has a large variety of products, which include apparel such as woven and knit garments and shoes; fashion accessories such as watches, gloves, scarves, sunglasses, and belts; home products such as food storage containers, bags, and bins; sporting goods such as balls, sticks, bats, and clubs, plastic toys; and travel goods such as airplane blankets. On the supply side, these products were sourced globally from more than 280 factories over the past 20 years. Of these suppliers, 40 are categorized as core suppliers, while the rest of them are non-core suppliers. About 60% of Greater China's products were manufactured by these core suppliers. Greater China's total revenue for 2014 was $30 million (**Exhibit 1** shows 2014 Greater China financial data). On the demand side, Greater China's sales are primarily generated from customers in the US. Primary clients include Nike, Delta Airlines, Starbucks, Boeing, New Balance and some SMEs (small and medium-sized enterprises). Ben essentially describes Greater China narrowly as a global import trading company with a relatively small staff (around 60 employees as of 2014); however, it brings additional consulting services and has endeavored to couple each one of its American customers with Asian suppliers as value-added services.

Greater China incorporates various management strategies into their business models. First, mass customization enables them to reduce the order cycle from several months to a few weeks, which saves customers a large amount of inventory costs. Mass customization refers to the manufacturing process of postponing the differentiation of a product or service to satisfy a certain customer order until the latest possible point in the supply chain. The intentional delay of product differentiation results in a maximum level of mass production and cost savings. The product differentiation in the import supply chain could be as simple as a variety of different colors or as complex as developing a completely new product.[2] Second, Greater China is able to offer its customers a competitive sourcing cost because of economy of scales or scopes. Many clients may demand the same standardized products, such as storage containers or airplane blankets, and suppliers usually offer quantity discounts for these products. Therefore, a single large demand can significantly reduce the unit sourcing cost. Individual customers, however, are unlikely to reach the discount amount threshold due to a relatively small demand size. With the consolidation role of Greater China, demands from different customers can be combined, and sourcing discounts can then be negotiated with suppliers. Third, Greater China successfully maintains a long-term collaborative relationship with many suppliers and customers. Because suppliers are reluctant to do business with unfamiliar customers due to credit risks, and because customers are also doubtful about the quality of the products manufactured by unfamiliar suppliers, Greater China's positive relationship with both sides provides a huge aid in reducing supply chain risks.

Challenges

Using Ben's own words, "Competition actually makes us better, not worse." By 2014, there were more than 10,000 suppliers and more than 25,000 distributors registered with Advertising Specialty Institute

[1] http://www.greaterchina-usa.com/

[2] http://www.entrepreneurial-insights.com/mass-customization-what-why-how/

(ASI), the promotional product industry's largest membership organization. Greater China has been continuously ranked among the top 40 suppliers. The fast growth of the number of suppliers and distributors doesn't squeeze the promotional product market, and in fact, it helps expand it by attracting many more customers; in particular, small and medium-sized enterprises. The company's slogan, "Delivering the Ultimate Importing Experience" has bolstered its performance and reputation ever since it joined the ASI. However, 2014 has been a difficult year for Ben and his company.

Ben's daughter was hospitalized during the second half of 2014 due to a serious illness. Ben left the company to take care of his daughter between June and December 2014 until she was fully recovered. During his leave, the company experienced a huge sales decline since Great China's business model highly relies on Ben's expertise. Many of the Chinese suppliers considered Ben the only decision maker in the company, although the customer side can be handled by his sale representatives. Due to the fierce competition in this market, pricing is a key issue in the negotiation process. Because of the long-term mutual trust in the trading process between these suppliers and Ben, a competitive pricing contract could not be achieved without Ben's involvement. Meanwhile, customers who sent in sales inquiries demanded a quick response. For example, if a sale representative received an inquiry of 50,000 units of customized blankets with the customer's logo on them, he needed to make a swift response on the unit price quote, the lead-time duration, and the quality assurance. Customers were not patient with their inquiries because they had many other suppliers and distributors from which to choose. However, without Ben's final permission and approval, the salesperson couldn't respond to the customer. While Ben was away from his office, it took a much longer time to respond to a particular customer inquiry. With the continuous loss of customers, Greater China's sales dropped by 25% for the last half of 2014.

Meanwhile, the expansion of Alibaba also negatively impacted Greater China's sales. Alibaba's enterprise model has many advantages.[3] The first is location. The company is based in China, a country with the largest population in the world, and the largest Internet market; almost twice the size of the US market. Meanwhile, e-tailing has been very popular in China during the recent five years, and has surpassed traditional retailing, evidenced by the tremendous continuous sales increase in Taobao.com – a subsidiary of Alibaba. The second advantage is economies of scope and scale. Alibaba has two retail channels: Taobao, featuring non-brand-name products sold by smaller, unknown merchants, and offering an astonishingly large variety of products, and Tmall, featuring brand-name products. The large variety of products through a single company and the large volume of sales on the two channels both lead to huge cost savings for Alibaba. The third advantage is large-scale networking. Panos Mourdoukoutas' article entitled "Alibaba's Five Advantages" on Forbes.com on April 15, 2014 notes the power of a network: "The benefits arise from an expanding network of users of a product or service. The larger the network, the more valuable the product becomes to each user. Alibaba is a form of 'collective entrepreneurship' between the company and thousands of merchants that join the network - Alibaba provides the platform, and the merchants provide the products. This model, which relies on revenue sharing rather than listing fees, makes it easier for additional merchants to join the network. And the larger the network, the greater the benefits for each merchant, as it attracts a large volume of customer traffic." The fourth advantage is the good relationship between the company and the Chinese government, which perhaps serves as the foundation of Alibaba's success. A good relationship is particularly important in China because of the government's involvement in the economy and influence over the players in all major industry sectors.

3 http://www.forbes.com/sites/panosmourdoukoutas/2014/04/15/alibabas-five-advantages

Mel and Ben discovered that the online B2B e-commerce giant could use the information from the Advertising Specialty Institute's membership list containing all Chinese low cost manufacturers to damage ASI suppliers and distributors. Ben gave his view of the online B2B revolution:

> "The Alibaba trading platform has a very dramatic impact. American customers such as Fortune 500 companies started looking at the trading information on Alibaba, instead of visiting our website or other competitors' websites. The information provided by Alibaba is not representative of the final cost. The Chinese manufacturers would submit their pricing on specific promotional or commercial goods that only include the basic production costs. They do not take care of the shipping or handling costs, not to mention the customs-related costs. In other words, most pricing contracts posted on Alibaba.com are only FOB (Freight on Board) *origin*, which means the buyers are responsible for all costs through delivery (i.e., shipping, handling, quality inspection, and customs costs). Therefore, these contracts are very competitive. However, the quote provided by Greater China is FOB *destination*. We are responsible for all costs from production to delivery. Customers are not fully aware of these differences, and hence they start negotiating with us. This has brought us a lot of headaches in that it does not allow us to maintain the same pricing strategies as before. Our gross profit is significantly reduced from 30% to 20%. In addition [to the impact that Alibaba has on our business], starting in 2012, we have to pay a very high fee on product physical and chemical testing, which further squeeze our profit margin."

What Ben described has another name – direct imports, which are populated by e-commerce. The Internet makes the world more flat in that people from different countries are able to communicate with each other directly, and hence transparency in the merchandising process is largely improved. It is perfectly legal to directly import and sell products into a country and not through the manufacturer's authorized distributor.[4] Consumers can save a lot using direct imports because they are eliminating the factory-authorized middleman. However, there exists one flaw in the trading process. The manufacturer's warranty and after-sales service may not be applicable because of the lack of local agents. In order to deal with this challenge, e-commerce corporations developed advanced techniques to establish a cross-border supply chain that enables international products to be delivered duty-paid to the customers' doorstep. The entire import supply chain management is facilitated by e-commerce companies such as Alibaba. For example, a traditional import supply chain consists of a foreign supplier, importer, distributor, retailer, and customer, while the supply chain built on direct imports has three layers: foreign supplier, online direct import facilitator, and customer. Thus, the elimination of intermediaries leads to high transparency and efficiency in the import supply chain management.

In Ben's opinion, the Alibaba e-commerce platform can only serve as a proprietary information reference, because the quote posted on the website merely includes production-related costs. The price is not reliable when the costs of logistics and import-export activity are not included. It is quite common for Chinese suppliers to make price changes when value-added activities are included, but, due to the transparency of the trading platform, customers are no longer accepting the old pricing terms set by Greater China. If Greater China cannot match the contract from Alibaba, buyers will switch to other suppliers or even directly contract with suppliers from China that are selling through Alibaba. Although most customers ended up with a higher total costs, they felt better because they did not spend more money on the production part. In response to this pressure, Greater China sought other suppliers that are

[4] https://en.wikipedia.org/wiki/Direct_imports

able to produce the same goods at a lower cost. More recently, the sharp rise of labor cost in China has made it more difficult to find appropriate suppliers that could deliver the same qualities. This led Greater China to think about looking for manufacturers in other countries, such as Vietnam, Thailand, or Indonesia, where textile industries are more prosperous and popular.

Prospects
Greater China has identified three areas that may lead to new growth in profits.

China's Impact
Ben returned to his office and resumed his normal work in January 2015. With these challenges in his head, he must decide the future directions of his company. Ben still believes that China is going to remain the primary subcontracting country for the next 10 years. This is because, for the past two decades, the Chinese government has continuously improved their transportation infrastructure such as roads, railways and seaports. This advantage cannot be matched by other countries within the next decade, Ben believes. Given this situation, Greater China must continue maintaining good collaborative relationships with those Chinese suppliers as they are capable of providing in-time deliveries with reliable qualities. Additionally, some customer orders must be sourced from China due to special customer requirements. However, a second sourcing country that has a significantly lower procurement cost is also needed due to the soaring labor cost in China.

According to China Business Review[5], "Infrastructure has opened the door to socio-economic development in China. Economic growth - facilitated in part by roads, water, and power investments - has helped pull roughly 700 million people above the poverty line in the last 20 years. China's extraordinary economic achievements have been made possible by a range of factors including export-friendly trade and investment policy, sound macro-economic management and political stability. The timely delivery of urban infrastructure has also been an essential driver of economic growth, underpinning the rapid development of industry and breakneck growth of cities in eastern China. China's road network has more than tripled in length in the last two decades; it is now half as long as that of the United States."

Meanwhile, as mentioned by the World Bank[6], "the transportation of containers by rail could grow substantially in China, especially if the nation continues adopting the kind of operating practices and regulatory reforms that have boosted the development of the North American rail network. A more intense use of rail as part of the country's containerized freight delivery logistics system could be a game-changer for Chinese manufacturers and consumers alike, as we have seen in North America…That's because more and more manufacturing has moved to China's western provinces, which increases the distance of international and domestic shipments." Labor and other costs are rising in subcontracting factories that are located on the east coast of China. The western part of China has potential for new factories that can produce products at a lower cost.

Expansion
Greater China has a plan of opening a brand new office in the metropolitan area of Philadelphia, PA, to expand the opportunities for face-to-face communications with their customers. "About 60% of Greater China customers are located along the east coast of the US, and therefore it is imperative to have an office closer to our customers," Ben explains. He says a simple walk-in visit is the best way to do

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5 chinabusinessreview.com/infrastructure-and-the-environment-in-chinese-cities-prospects-for-improvement/

6 worldbank.org/en/news/press-release/2015/03/18/containers-on-rail-china-next-big-opportunity-in-supply-chain-logistics

business compared with sending in inquiries through phone calls or the Internet. Customers will receive first-hand information about Greater China's products. Most importantly, Greater China will be able to work directly on product customization and contract negotiations on-site with clients. Philadelphia provides Greater China with a location convenient to headquarters for east coast clients in a lower operating-cost city than others on the east coast. Over the next 10 years, Greater China plans to open more offices in New York City, Chicago, Houston, and Toronto, to expand their business to every corner of North America. The revenue of Greater China from Canada is about one third of that from the whole US, making the Toronto office one of the most important strategic moves for this company.

Greater China also plans to establish relationships with the suppliers in Vietnam as an alternative sourcing country. One of the advantages of sourcing from Vietnam is that suppliers are exempt from the tariff fee charged by the US customs on products imported from China, which largely lowers the total cost. Vietnam is chosen as an alternative also because of the increasing costs in China and India. Vietnam is currently one of the top 30 countries for outsourcing services, and has steadily improved through a working-age population surge and a rise in foreign investments. Language barriers in Vietnam are fading away because English is required to be taught in schools, and it is now not difficult to find an articulate and consultative workforce in Vietnam. However, there are still some downsides to sourcing from Vietnam. The country is considered as an alternative because outsourcing costs in China are rising, but the industry and transportation infrastructure of Vietnam are not comparable to that of China. It is still young in the global outsourcing and offshoring market. In addition, importers in the US such as Greater China are not familiar with the politics and rules of Vietnam, making the global trading business even more difficult to establish.

Export

Greater China is interested in exploring the possibility of exporting products from the US to China as part of its strategy to boost profits in light of competition from Alibaba. Thanks to the good relationship with Chinese suppliers and the government, Ben sees an opportunity to export to the Chinese market. China has had a huge demand for foreign wine and liquor for many years as a result of the growing middle class and the perceived health benefits of wine consumption. IWSR, a research firm that specializes in the wine and spirits industries reports that between 2010 and 2014, China's consumption of wine increased by 36%. Chinese consumption of wine in 2014 was more than double that of the number two consuming country, the United States. Ben believes Greater China will be better positioned to take advantage of this demand than many other companies. In fact, Greater China has already started their wine export business to China with their own brand, "HarvardRen Wine" (Ben has received certificates from executive education classes at Harvard University).

Another competitive advantage Greater China has in exporting to China is their familiarity with China's import/export processes. It is required by Chinese government for importers to present a health certificate and a certificate of origin in order to clear inspection by the Entry-Exit Inspection and Quarantine Bureau at the entry port. While not many Chinese importers are familiar with this process, companies like Greater China are adept at it.

China is also a major importer of high-end products such as luxury clothing, shoes, and bags. The luxury apparel market is currently dominated by European, Japanese, and American brands. The tariff on apparel to China was reduced after they joined the World Trade Organization, making these products more affordable to Chinese consumers. The resulting sales increase in high-end products opens another potential business opportunity for Greater China.

Questions

1. What are Greater China's competitive advantages? What are Alibaba's competitive advantages? What makes for successful management of an import supply chain?
2. What global supply chain management strategies does Greater China propose in order to counteract emerging challenges?
3. Will these plans proposed by Greater China work elsewhere in other industries where globalization is also present? If not, why not?
4. What other global business strategies do you think can be applied to help Greater China in the future?

Appendix: Financial Statements

Greater China Industries Income Statement 2014 (USD)

INCOME	
GCI Sales	24,658,038
Rebates - GCI	(74,668)
Total Product Sales	24,583,370
COST OF GOODS SOLD	
PRODUCTION	
Bad Debt	(1,198)
Production	14,688,290
Sample	14,065
Compliance Testing	12,417
Project Specific Testing	184,011
TOTAL PRODUCTION	14,897,584
INTERNATIONAL SHIPPING	
Airfreight	856,401
Cargo Insurance	24,203
Courier	187,171
Duty	1,016,469
Filing Fees	88,952
Ocean Freight	807,398
TOTAL SHIPPING	2,980,593
DOMESTIC SERVICE	
Fulfillment	49,787
Inland Freight	525,136
Pallet & Whse Handling	146,113
Removal & Dumping	128
Storage	17,095
TOTAL DOMESTIC	738,260
TOTAL COGS	18,616,438
GROSS PROFIT	5,966,930

EXPENSES	
MARKETING, ADVERTISING & PROMOTION	
Advertisement	210,144
Dues and Subscriptions	12,548
Marketing Outreach	9,853
Promotional Expenses	85,828
Travel, Entertainment, and Hosting	144,902
EMPLOYEE	
Automobile Expense (insurance, leasing, mileage)	48,974
Insurance and Emp. Taxes	444,043
Recognition/Awards	50,849
Recruiting	21,283
Staff Training	7,674
Subscriptions	1,970
PAYROLL	
Bonus-Administration	10,000
Commission	1,949,515
Outside Labor	40,491
Payroll Expenses	20,728
Salaries-Administration	1,546,896
OPERATIONS	
China Office Expense	470,315
Depreciation Expense	75,775
Dun & Bradstreet-Subs	2,519
Equipment	6,624
Equipment Rental	10,830
Insurance business	31,702
IT costs	5,850
Lease	324
Licenses and Permits	9,623
Maintenance	89
MAP Meeting expenses	72
Office Expense	32,608
Postage and Delivery	104,964
Rent	239,001
Staff Meetings & Parties	12,820
Telephone	50,758
Vendor Audits	1,888
PROFESSIONAL FEES	97,085
FINANCIAL	
Bank Service Charges	30,006
Merchant Card Fee	26,247
Brokerage Fee	11,742
Interest Expense	3,051
Payment Processing Fee	24,264
Penalties and Interest	6,230
OTHER	18,685
TAXES	27,255
TOTAL EXPENSES	5,906,046
NET ORDINARY INCOME	60,883