An insider's look
at options for manufacturing in China

Table of contents

Author's Perspective

During my 20 years living in Asia, I've owned a number of different business entities in greater China, ranging from China manufacturing WFOE's to service companies. All of them involved recruiting, training, managing and sometimes dismissing local staff.

China is not only a massive market but it changes rapidly, so I don't claim to be an expert on all aspects of your China business; and anybody that claims to know "everything about China" should not be taken seriously! I've had my share of success as well as failure, and in this whitepaper I'd like to share some of the key lessons, pitfalls and best practices that I learned the hard way when answering the deceptively simple question of "what are the options for manufacturing in China?"

What's Covered?

WFOE vs JV vs Contract Manufacturer vs Sourcing Agent
Pros & Cons
Pitfalls and best practices
Introduction to PassageMaker and the Hybrid model

Terminology

"Manufacturer" vs "Supplier"
For the sake of this whitepaper, the term "manufacturer" is used loosely to cover all types of processing including light assembly, custom packaging, warehousing and any other situation where the reader wishes to have laborers in China "make" something for them.

However, I don't consider trading companies and agents to be manufacturers (even if they try to convince you otherwise!) unless they actually own the factory (they almost never do). "Supplier", "Seller" (or "con-artist") is a term more appropriate for those entities.

WFOE

"WFOE" stands for "Wholly Foreign Owned Entity". The non-Chinese party owes the means of production. There are many variations to the WFOE, such as "trading WFOE", "service WFOE" or "manufacturing WFOE". But what makes the WFOE special is that this type of business structure does not require any Chinese partners, yet the business is on a level playing field with Chinese owned businesses (at least in theory, from a legal perspective).

If you a want to directly employ a team in China under your own China based entity, which will be owned by you, without any local partners, then you are thinking about a WFOE.

Joint Venture (JV)

"Joint Venture" means a lot of different things to different people, but for the sake of this resource, when I say "JV" I am referring to partnership between a local Chinese company and a western investor to co-own and co-manage a dedicated production facility in China.

If you are thinking about investing in a Chinese factory which will produce your given product, then you are thinking about a JV.

Contract-Manufacturer (CM)

In this model the buyer places an order to a China-based manufacturer who (in theory) owns the factory, organizes the BOM (bill of material), controls quality levels and completes the production per the agreed schedule in exchange for a pre-agreed fee.

If you are thinking about placing an order direct to a factory in China, then you are talking about CM.

Agents/Trading Companies
These intermediaries go by many different names such as agent, trading company, import/exporter, sourcing agency, buyer's representative, factory representative or broker. What they all have in common is that they don't own the means of production and they are placing the PO on behalf of the actual buyer to the actual manufacturer. Many agents and trading companies will market themselves as a CM, but for the sake of my article, if their name is not on the business license of the factory- then they aren't a manufacturer. I don't care how much "control" they say they have over the factory, or if it's "owned by their cousin".

If you are thinking about engaging a 3rd party to manage the supplier for you, then you are thinking about hiring an agent.

Selecting The Right Option For Your Particular Manufacturing Needs

For each of the above mentioned supply options, as well as some of their lesser known variants, I'll go over the pros and cons in great detail. My goal is to help the reader identify the best option for their particular needs as selecting the right partner is the single most important step in the overseas manufacturing process. And the "right" supply option is highly dependent on the buyer's particular mix of order size, budget, available time, quality level, intellectual property exposure and general China understanding.

How this Whitepaper is Organized

This probably isn't the first article you've read about China business. So to provide real value for the readers, in addition to some of the "you probably know already" stuff included in this whitepaper that is common knowledge and generally agreed among experienced China business professionals, I have added the following bonus sections:

- *"You may not know" provides insider information that comes with 20 years' experience serving on both sides of the buyer-seller relationship in China.*
- *"Dangerous not to know" may or may not be common knowledge, but you better be aware of it either way.*
- *In the "Yeah, I said it" section, I stick my neck out a bit to offer some predictions and deal with touchy subjects and I warmly welcome your feedback, even if it's not complementary. I appreciate a constructive dialogue!*

Before we get into the pros/cons, let me explain the 5 key criteria I am using to help readers make a decision about which production option is best for their particular needs.

1. **Level of Chinese Expertise Required**
How well do you need to know the language, business culture & legal systems?

2. **Typical Order Size**
Does the buyer have to be of a certain size?

3. **Control**

Over Lead-times, Intellectual Property, Quality Standards, Social Compliance & Price How exposed is the buyer to non-confirming goods and are there additional costs needed to ensure quality standards are achieved? How hard is it to be a responsible corporate citizen in terms of workplace safety, labor practices and environmental protection? How exposed is the buyer to having their ideas ripped off?

4. **Transparency**

Does the buyer get to know the true identity, compensation and motives of the key players in the supply chain?

5. **Tax Complications**

What's the impact on global taxes and the costs of filing at home or abroad?

The JV Era Is Over. Thanks Goodness!

This whitepaper doesn't spend much ink covering the pros and cons of a manufacturing Joint Venture with a Chinese company because in today's China, the cons far outweigh the pros and the only investors considering setting up a Joint Venture with Chinese companies are doing so because the Chinese laws forbid 100% foreign ownership in certain sensitive or strategic industries.

As most readers of this white paper are not purchasing military grade electronics or raw natural resources from China, there is no need to discuss the ins and outs of setting up a JV factory for processing. And if I did cover it, I would end up spending the whole time telling you a bunch of horror stories from back in the 80's and 90's, when the JV was the only way to own the means of manufacturing.

"Yeah, I said it"

Let's give credit where credit is due. China was dirt poor in the 80's, yet their forward thinking government basically said "let's trade our low cost labor for their technology and capital." It worked so well that for many product categories today "you can't not manufacturer in China."

Sure, your shoes and socks may come from Pakistan, but production of value added goods (think iPads and auto parts) is firmly entrenched in China. The JV was the tool for the transfer (sometimes theft) of this capital & technology. A weak legal system and lack of intellectual property rights only helped ensure the transfer went mainly in one direction!

The JV was the tool that transferred the technology to China. Now that China is in possession of the IP, we "suddenly" find the Chinese government championing the rights of brand owners, patent holders and inventors. Well, at least better late than never!

As part of its obligations under the WTO agreements, China has dramatically reduced the list of sensitive industries and the doors have been opened wide to foreign investment. It's also worth mentioning that in the past 20 years the legal system has developed and intellectual property rights are finally being respected.

In today's China, the JV is dead and the WFOE is king.

Pros/Cons: Wholly Foreign Owned Enterprise (WFOE)

The main advantage of having a WFOE is that you are in control of your own destiny. It's your people on the ground and as long as they stay loyal and/or you have robust monitoring in place, you don't need to share ownership with local partners.

"Dangerous not to know"

It's very dangerous to put too much trust in any one individual and expect them to "look after your shop for you" in China. Monitoring a team (Chinese or not) on the other side of the world is possible but not easy. It takes a system based approach. For example, I had a local employee who was dismissed from my China WFOE for performance issues. He felt slighted and wanted revenge. He faked my corporate chop and used it to extract (steal) my tooling from my sub supplier's factory to be used as ransom against me. Because we had a system for monitoring the status of tooling and tracked the location of our official corporate chops, it was very easy for us to show the police that a fake chop was used and they were able to recover the tooling and punish the criminal. He did a year in a Chinese jail. In that story, it worked out for the non-Chinese party, but in the vast majority of cases, the illicit activities of the WFOE's own employees (be it collusion with suppliers, creative book keeping, bribe taking....) go undetected until it's too late.

"You may not know"

Setting up a WFOE in China is a lengthy process. For example, even after you have a company set up, it can take additional time to get the "normal tax payer status" and then you can apply for the right to process your own VAT. In my experience the full process can take from 8 to 18 months.

If you engage an agent to help set up your WFOE, be clear about what you wish to accomplish with your WFOE, and make sure they can give a quote for the whole process. Too often the client goes with a low cost agent only to find out the cost was low because they agent is handling some but not all of the critical steps.

A WFOE requires a significant upfront investment; two big investments are Registered Capital and Physical Space.

The PRC government uses the registered capital requirement to achieve two goals.

First, by having a large capital requirement they are raising the bar and preventing smaller and underfinanced companies from setting up in China. China's economic development was based on attracting large companies with experience and deep pockets.

"You may not know"

It's a bit of a catch 22, but one counter intuitive aspect of the WFOE process is that you can't get approved to do business unless you have a formal contract for rent or land purchase. But you can't start doing business until your WFOE is approved.

So if you make the investment in land and buildings, you want to make sure that your application process is running in parallel with your building schedule. If not, you could end up having a beautiful factory that sits there idle while you wait for your paperwork. Even if you are renting a space in China, you will need to sign a lease with the landlord first and start paying rents upfront while you wait for your WFOE paperwork to be bought together. Landlords know how the system works and it is very rare that they will let you sign a lease now, but start paying rent later.

You can make the most of this downtime by re-decorating, setting up the production line / office and recruiting initial staff. But technically you can't hire people until the WFOE is done, so it's very much a gray area; be careful.

Some in-process WFOE's go so far as to cross the line between testing to trial production. If you go that route, don't expect to actually ship any of the goods out of the country until your WFOE paper work is fully completed. And realize that if an audit takes place, the local official will have the right to fine you or reject your WFOE application if you are perceived to be running production rather than conducting training and setting up your shop. To add insult to injury, it will be next to impossible to apply for a VAT rebate on items that were produced in your shop in advance of the completion of the WFOE.

I have been in China almost 20 years, speak the language, have plenty of intelligent local friends to lean on, BUT I would never try to set up a WFOE on my own without the help of a registration agent. This isn't like setting up a company in Delaware where you can register the business online overnight. Overlooking the tiniest of details can have catastrophic impact on the ability of the WFOE to perform as planned. Legally, yes a foreigner has the right to apply for a WFOE on their own. We also have the right to jump head first off the Great Wall of China. That's doesn't mean it is a good idea.

Should I Let The Landlord Or Local Government Set Up My WFOE?

In order to get you to buy land or rent factory space in a certain area, the landlord or local government may entice you by offering to handle the WFOE formation for fee or at low cost. This can be very dangerous. It may sound good at first, but your incentives are not aligned. They have the goal of rushing the papework to get your investment. You should have the goal of structuring a WFOE that protects your long term interests.

"Dangerous not to know"

Additionally, be extremely careful if the landlord introduces a registration agent and/or if the landlord is the local government. It's very hard to negotiate with the municipality and almost impossible to sue them if they mess up your WFOE. Keep in mind the judge on the case will be a government employee. Good luck with that!

I make no attempt to hide the fact that using a registration agent is the best option. For me, the real issue is not to use or not to use an agent, but rather, which agent should be engaged. There are basically three choices.

Generally speaking, the large multinational consultants and accounting firms (you know who they are from the adverts on CNN) will do a fine job. But the fees they charge can be as big as their billboards at the airport. Just because you use those firms back home for your accounting, doesn't mean they are the right choice for your WFOE set up in China. Explore all your options and make an educated decision.

Next we have the "local-western hybrid" registration agents. These firms are often owned and managed by Westerners, but focused exclusively on China business. I like using these kinds of agents because they have the local knowledge, but also have the western mind set for customer service. Unfortunately, their pricing can be all over the place, so make sure you ask around and deal only with a reputable firm.

To be fair, I should also point out that there is no shortage of Chinese registration agents in China. Once again, there is significant variation in price and professionalism within this group. But as a general rule of thumb, you can expect the services of the local firms to be priced lower than the other two options above. But you often get what you pay for.

Regardless of who you choose make sure you ask four essential questions:

- What is and isn't covered in their fee structure?
- Can the service fees be linked to the key project gates?
- Do they have their own staff on the ground and/or experience in the district where you wish to set up the WFOE? Notice I said "district" and not "city" or "province"! Local knowledge is critical for a smooth WFOE set up.
- Can you get a few references from their clients who have used their services to set up a WFOE?

All In Costs For A WFOE

Here is an overview of fees to set up in South China:

1. Registration Agent: Depends on the agent and size of the WFOE. But even for a small trading WFOE (no manufacturing) I don't know of any professional agents that charge less than 16,000 USD for the full service Trading WFOE set up. Manufacturing WFOE's are more complex and I have seen billing range from 50,000 to 500,000 USD.

2. Registered Capital for Manufacturing WFOE in Guangdong is hundreds of 1000's USD (luckily not Millions!) in most cases.

3. Government costs/fees + Tax fees + Application fees depend on the location and exact details of the WFOE but can range from 4,000 USD to 10,000 USD for the simple WFOE.

The physical set-up costs depend on location, buy vs. rent, size of factory, equipment and decorations.

The on-going costs of the WFOE depend on # of employees, salary, taxes, BOM, utilities, rents and such.

"You may not know"

8 Critical Items for WFOE set up

For your reference, here are some of the items that some business people often overlook when thinking about setting up a WFOE.

1. *Scope of Business. If your WFOE is set up to export shoes and later you wish to do electronics, you may have significant roadblocks to deal with.*
2. *Trading WFOE vs. Manufacturing WFOE. Are you clear on the difference and sure which one is best for your needs? Did you know VAT rebates are slightly different for the two WFOE's?*
3. *Need Additional Licensing (domestic sales? Import/export? VAT?)*
4. *Are there location or industry incentives offered by China government to the WFOE? What's the catch?*
5. *China Tax Planning. In China the WFOE has to report monthly and annually, so not only do you need good tax planning, but you also need to budget for the man power to process all the paperwork.*
6. *Global Tax Planning. The tax rates in HK, PRC and your home country are not the same. Structure your business in China to avoid unnecessary tax exposure while not breaking any laws in any of the jurisdictions where you operate.*
7. *Plan for Profit Repatriation. Making money in China is nice. Spending it back home is even nicer. Make sure you have a plan for how to get your earnings overseas into your pocket back home.*
8. *Budget. Get a firm handle on the true costs to set up and run your business. It is not uncommon for the investor to sink money into a WFOE only to lose that investment because they were underfinanced and never got the point where the doors were open and revenue could be realized.*

Having your own WFOE can be a wonderful thing- more control over the supply chain, reduced costs in the long run and improved protection of IP; but a mistake in any of the 8 areas above can be devastating to the business causing great loss of money and time. So plan accordingly and do your homework.

WFOE: Key Points

	WFOE
Level of Chinese expertise required	very high
Typical Order Size	very large
Control of lead times, IP, quality standards, social compliance and price	very strong
Transparency	high
Tax complications	very high

Level of Chinese expertise required: very high

Why? Obviously, owning and operating a business in China is a lot more complex than buying from a Chinese seller. While there are upfront investments and administrative burdens not found with the CM, Agent or Hybrid models, in theory, by cutting out all intermediaries and manufacturing things on your own, you should be able to achieve very competitive pricing.

Typical Order Size: very large

Why? As a rule of thumb, in most industries, the headaches and upfront investments that go along with setting up a manufacturing WFOE are well worth it when the annual order size is over 20 million USD per year. Under 10 million USD per year and it's almost always more economical to outsource production to a professional Contract Manufacturer.

Control: Strong

Why? Assuming you have a solid grasp on how to manage a factory and build a quality product, then by having everything done in-house you have much more control over the process.

Transparency: high

Why? As owner of the WFOE you pick your own sub suppliers and service providers. Total transparency.

Tax Complications: very high

Why? Not only do you need to sort out Chinese taxes for your WFOE, its products and employees, but by owning an entity in China, your tax filings back home may become much more complicated depending on how your government views ownership of overseas assets and the repatriation of profits.

Related Content: **What is VAT and why should I worry about it?**

Contract Manufacturer (CM)

In this model the buyer places an order to a China-based manufacturer who owns the factory, organizes the BOM (bill of material), controls quality levels and completes the production per the agreed schedule in exchange for a pre-agreed fee. For the sake of this article, "contract manufacturing" is the same as "sourcing direct from the factory" as they say. There are no intermediaries involved and you, the buyer, are dealing direct with the factory.

Finding/Managing Contract Manufacturers In China (Video Resources)

In this section of the white paper, I'd like to offer some visual resources that cover:

If you a want to directly employ a team in China under your own China based entity, which will be owned by you, without any local partners, then you are thinking about a WFOE.

9 video crash course in how to go about finding suppliers

7 part video on how to spot a good factory and avoid a bad apple

"You may not know"

Two hidden headaches when dealing with a contract manufacturer

Convertibility Issues

Some larger buyers start off sourcing from a CM with the false assumption that they can easily convert over to a WFOE at a later point if the project grows. The majority of CM's will find all sorts of reasons (some true, some fabricated) for why you can't leave them. CM's are great at using the following methods to lock in buyers for the long term:

1. Ambiguity over ownership of tool & dies
2. Hidden allegiances between CM and sub-suppliers
3. Manipulation of the IP.

   "Dangerous not to know"

   China is a "first to register" not "first to market" system. If your CM registers your logo in China before you do, then you can't product your product without their approval. Crazy! But it happens.

   "You may not know"

   Registering IP in China is easy and affordable. Protecting a logo costs 100's not 1000's of USD and I consider it an essential step, even if you have no plans to sell in China. Reference pricing is available at ***www.AsiaBridgeLaw.com.***

4. Manipulation of the product registration.

   Some products, even if only for export, need to have the CCC mark in China. If your supplier registered the CCC under their name with or without your knowledge, it may not be easy to switch suppliers.

5. In the absence of a well-written contact about non-confirming goods, contract manufacturers have been known to ship defects on purpose so that the buyer is locked into placing a future order where the defective merchandise will be replaced.

Admin Burden/Project Management

When setting up a WFOE, we naturally expect the extra workload for administration and project management because we are managing production and coordinating the supply chain ourselves. But you may be surprised to find that your factory with 1000's of employees doesn't even have a customer service team, let alone project management software. If your account manager belongs to the factory's sales team, you can expect them to put in a lot of energy to close the deal, then disappear once they get their commission.

"Dangerous not to know"

Back home, when you place an order to a catalog, retailer or even factory, that step is towards the end of the sourcing process as the desired goods will arrive and there is not a lot of follow up work needed between placing the order and delivery. Almost the exact opposite in China. Placing the PO is just the start, and quite often, the buyer, rather than the supplier ends up doing the project management work to coordinate the order. I have run into a number of new buyers who failed on their first China sourcing attempts because they didn't calculate the time and energy needed to manage the projects. When going factory direct, you really need to roll up your sleeves and get involved.

Contract Manufacture: Comparisons & Key Points

	CM
Level of Chinese expertise required	medium
Typical Order Size	medium
Control of lead times, IP, quality standards, social compliance and price	weak
Transparency	medium
Tax complications	low

Level of Chinese expertise required: medium

Why? Obviously, owning and operating your own factory in China is a lot more complex than buying from a Chinese seller. But even as a buyer, you need to be aware of the common scams and sourcing pitfalls to give yourself a higher chance of success. There are great factories as well as horrible ones, so finding the right factory early in your program will pay dividends later.

You need not be a "China expert" to buy from a Chinese contract manufacturer, but the more you know, the safer you will be.

If you want to get a feel for just how bad things can go wrong, visit **www.SupplierBlacklist.com**. And check out my course at **www.ChinaSourcingAcademy.com** to learn best practices and successful strategies for dealing with contract manufacturers.

Typical Order Size: medium

Why? Small buyers gravitate towards agents and if your order size is really big, you set up your own WFOE in China. The Contract Manufacture's MOQ fits in the middle.

"Dangerous not to know" "Yeah, I said it".

If a large CM welcomes your small order, it may be to use you as a stepping stone to something else. For example, they may want to glean marketing understanding and buyer contacts from you before cutting you out of the loop. If you have proprietary technology, require custom tooling and your orders are small, yet the price is low- it may be because the supplier has his sights on stealing the technology.

Control: weak

Why? You may think that going "factory direct" allows you control over the production line. That's what Mattel thought until lead showed up in the toy's paint. Just because you have a contract to make something a certain way, is no guarantee that the factory will actually produce it that way. Monitoring is essential. To further complicate matters, most CM's don't disclose where the BOM comes from or how much they are paying for labor and raw materials. If you don't know where the BOM is coming from, how do you ensure your intellectual property is being respected? CM's have multiple clients, so your lead times are impacted by the CM's staff allocation. It's safe to say that large orders or orders with fat margins go to the front of the line.

Transparency: medium

Why? Most agents won't tell you where the production is taking place because they worry you will cut them out of the loop. So in bypassing the agents and going factory direct, you have at least increased your transparency from low to medium. Yet for the reasons explained in the section on "control," visibility further up the supply chain behind the CM is limited.

Tax Complications: low

Unless you are using your HK office to purchase from mainland China and/ or buying EXW from the factory, there are no major tax complications when purchasing under FOB terms from a Chinese manufacturer.

Agents/Trading Companies

These intermediaries go by many different names such as agent, trading company, import/exporter, sourcing agency, buyer's representative, factory representative or broker. What they all have in common is that they don't own the means of production and they are placing the PO on behalf of the actual buyer to the actual manufacturer. Many agents and trading companies will market themselves as a CM, but for the sake of my article, if their name is not on the business license of the factory - then they aren't a manufacturer. I don't care how much "control" they say they have over the factory, or even if it's "owned by their cousin".

I had a taxi driver once tell me his family "owned the factory" and could get me a great "inside deal". The guy kept a bunch of random factory brochures in his trunk and tried to sell every (dumb) foreigner that got into his cab. If you expressed an interest, he would drive you to the factory "for free" for a tour, then work out his commission with the real owners later.

"Yeah, I said it".

I don't have much empathy for buyers who get taken for a ride by this taxi driver or his modern day cohorts that set up websites claiming to "own the factory". Most buyers don't do enough due diligence and they pay the price. Shame on them! There are some great factories out there, and a lot of bad ones. It's up to us, as the buyers, to find the good ones. It's not easy, but it is possible. If it were easy, there would be no role for the agents discussed in the next section.

When To Use An Agent?

If the intermediary is providing legitimate value (for example logistics, project management or quality inspection) then perhaps there is a place for them in the supply chain. But if the intermediary is not transparent in where their margin lies, then most likely the actual value for their inspection or project management service has been greatly inflated. Before you sign up with an intermediary simply ask that they separate the costs for their "service" from the "production costs". If they fight this, then you know their actual value to you is minimal.

Three Major Concerns When Using An Agent

1. **Quality:** If the middleman makes his margin by adding a markup to the product, then he has an incentive to steer the buyer towards the supplier where he can add the biggest margin, which is often his cheapest and lowest quality option. The middleman's interest is not aligned with the buyer's interest to find the best price/quality ratio.

2. **Security of IPR (intellectual property rights):** If the middleman does not disclose the actual location of production, then the buyer has no way of knowing who has access to sensitive design and branding. The use of middlemen is the #1 reason knock offs are so prevalent in China, as too many buyers have no idea who is actually making their product. If you don't know who is making it, you can't control your IPR. Furthermore, unlike a factory, which has laborers, equipment and actual facilities, middlemen have few physical assets and can disappear into the Zhejiang or Dongguan mist when there is a problem such as a lawsuit about IPR infringement or quality recall.

3. **Communications:** To avoid the buyer cutting the middleman out of the loop, the middleman will do all he can to keep the buyer from knowing the identity of the actual manufacturer. This extra layer increases communication lead times and prevents the buyer from talking direct to the people who have the most knowledge about the product - the engineers on the production line. This muddied line of communication is particularly troublesome when technical problems arise in production and the factory engineering team and the buyer must communicate via a middleman who may not have the technical understanding to explain issues properly.

Agents: most over-promise and under-deliver.

"Yeah, I said it".

Assume all sellers are middlemen until proven otherwise! The most common spin you will hear from the western middlemen is that "they leverage their overall buying power to help you get the best price with the factories they have pre-qualified." 99% of the time this is not true and is simply a slick sales message to make the buyer feel safe and keep you at arm's length from the factory.

Chinese middlemen may even say that they "own the factory", but when it comes to factory visits you hear excuses like "the power is off" or "let's just meet at our HK sales office" in hopes you never get to see the production base. If the middlemen above simply stated they were outside sales agents it would at least be ethical, but of course then the buyer would know they are not the actual factory.

How to Spot a Middleman

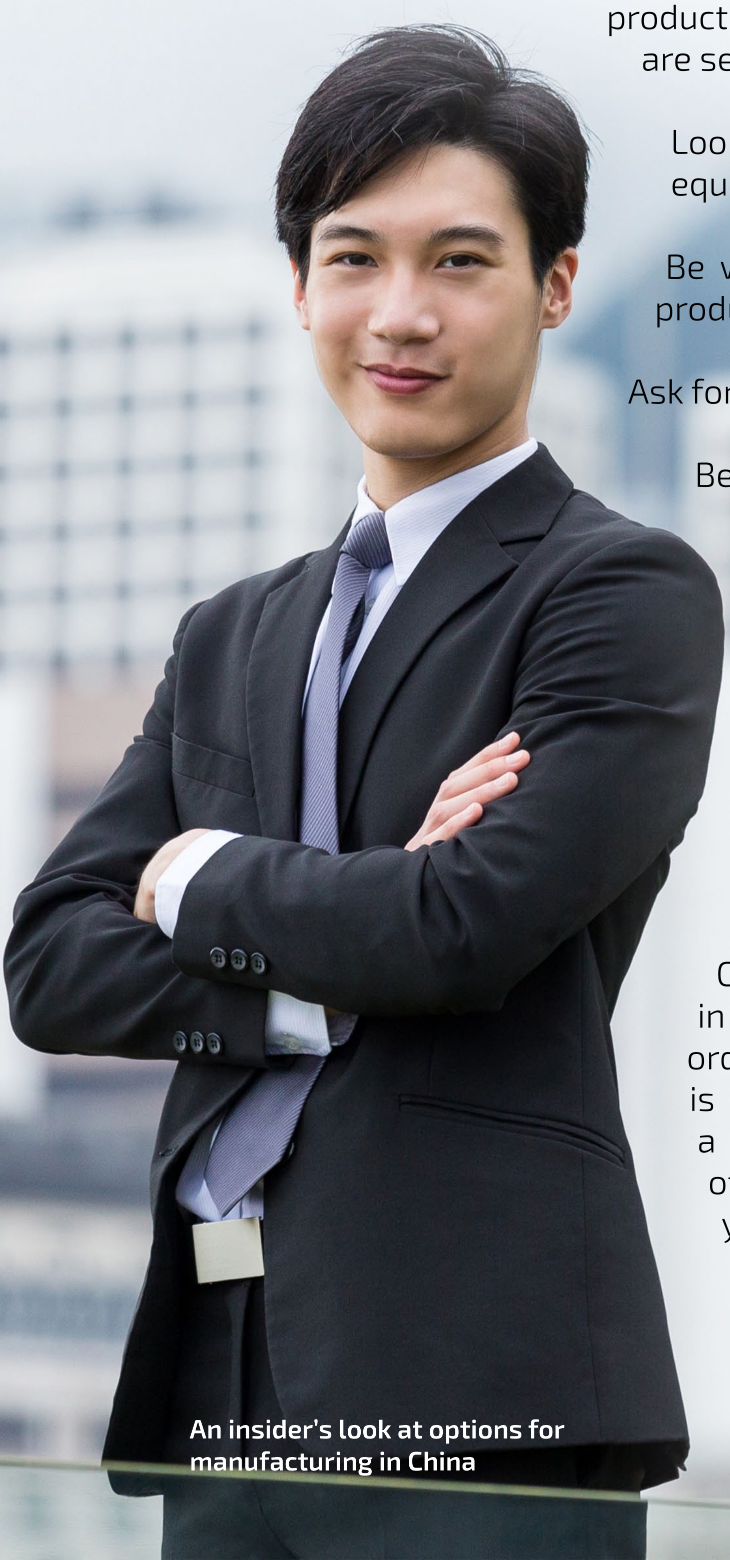
Avoid factories that refuse to list the name or location of the production facility.

Focus on those factories that can clearly show production experience with your particular product or production method. They should have samples and quality documents readily available if they are a real factory.

If you are able to arrange a factory visit:

Do your contact's business cards match the factory staff's information? If the cards don't match in name, color and address, then your contact is probably a middleman.

Do the people at the factory clearly know your contact or does he give out business cards to factory staff when giving you the tour of "his factory"? At worst case this may be his first time working with the factory and you may as well build your own relationship without him.



Be aware that polished English skills do not reflect production skills. Often the most polished websites are set up by trading companies.

Look for clear information about operation size, equipment and staffing.

Be wary if they supply a very large range of products.

Ask for ownership papers of the factory.

Be explicit that the production location may be audited by you in person and that this location cannot be changed without approval from buyer. (You would be surprised at the number of middlemen who will take the buyer on a visit of a factory only to change the location to a less expensive and poor quality option after the buyer leaves)

The Good News

China has a massive production base, and in most cases, assuming you are purchasing orders of over 100,000 USD per year, there is no need to use a middleman as there is a factory out there with just the right mix of price, quality, service and lead time for your particular sourcing program. It is my strong belief that the vast majority of China

Sourcing Agency: Comparisons & Key Points

	Agent
Level of Chinese expertise required	low
Typical Order Size	low
Control of lead times, IP, quality standards, social compliance and price	very weak
Transparency	low
Tax complications	low

Level of Chinese expertise required: low

Why? In theory, in exchange for their commission, the agent will represent you in China and they handle everything.

"Dangerous not to know"

But what if they are also making a hidden commission from the factory? Do they have your best interest in mind?

Typical Order Size: low

Why? If your order size is really large, you set up your own WFOE in China. If your order size is medium, you find a contact manufacturer. Agents help buyers who are unable or unwilling to go factory direct.

Control: very weak

Why? Fundamentally, the agents try to make a living by buying low and selling high. This may involve changing sub-suppliers without your knowledge in order to put more money in the agent's pocket. Small agents may not even have the buying power to go factory direct. So your agent may be dealing with another agent! Happens all the time. What a mess.

Transparency: low

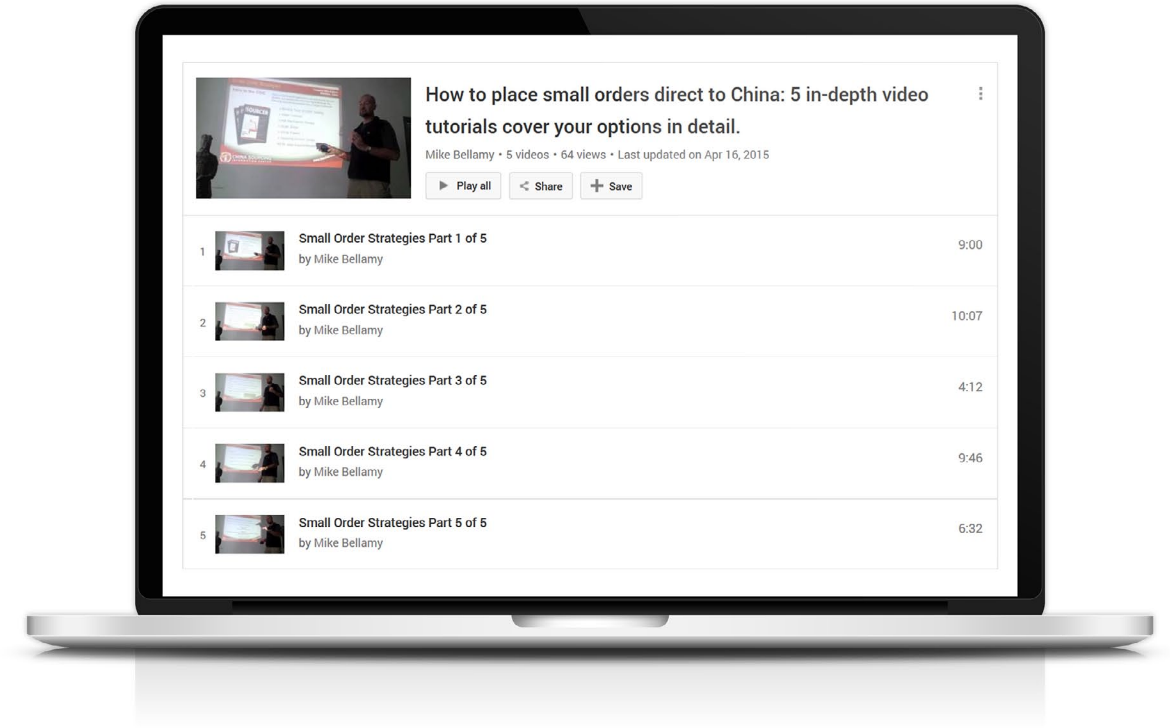
Why? Many agents are worried that if the buyer meets the factory, the agent will be cut out of the loop. So they keep the buyer at arm's length with as little transparency as possible.

Tax Complications: low

Why? Unless you are buying EXW from the agent, you need not be responsible for clearing Chinese outbound customs and sorting out local taxes. Inbound taxes into your destination market depend on the terms negotiated with the agent. Make sure you are clear about those before you place the PO.

Related content:

I created this video series to help buyer explore options for placing small sized orders with agents and factories.



Introduction To PassageMaker And The Hybrid Model

	WFOE	CM	Agent	Hybrid
Level of Chinese expertise required	low	medium	low	low
Typical Order Size	low	medium	low	large-medium
Control of lead times, IP, quality standards, social compliance and price	very weak	weak	very weak	very strong
Transparency	low	medium	low	high
Tax complications	low	medium	low	low

“Factory In A Factory” Overview

For companies that want greater control over the production process, but prefer to avoid the headaches associated with owning and operating a facility in China, PassageMaker offers the **“Factory in a Factory”** option which is a hybrid of the agency and contract manufacturer model where PassageMaker’s WFOE is leveraged to the benefit of the client.

PassageMaker leverages its China-based infrastructure (China-savvy management, SOP’s, Business templates, Quality systems, Factory space & Business licensing) to recruit, employ, train & manage the man power needed to manufacture, assemble, inspect and/or package the client’s product at a dedicated production area within one of PassageMaker’s existing factories.

Scalable & Flexible

If the client wishes to take formal ownership of the production line at some point in the future, the **“factory in a factory” can be moved to a stand-alone facility** (often in the form of a WFOE) under new ownership in a seamless fashion.

Conversion to a WFOE does not necessarily mean an end to the PM-Client relationship as most clients may retain PassageMaker as service provider, trusted advisor and/or equity partner.

No MOQ

While the typical client purchases between 2 and 20 million USD per annum in China, if your project is large enough to support at least 1 full-time China-based support staff, PassageMaker can be of service!

Protecting Intellectual Property & Sensitive Information

Due to Intellectual Property concerns, buyers can be hesitant to give a Chinese supplier too much information about assembly specifications, packaging & branding.

- Semi-finished goods or components can be shipped to our assembly & inspection center where we perform inspection, final assembly and/or custom packaging under a secure US-managed system but at local labor rates. While the client has total visibility as to the identity and pricing points of all entities in the supply chain, the "Black Box" keeps the suppliers at arm's length from sensitive information. (Read more about the Black Box Concept.)
- Shipping costs are reduced through freight consolidation and quality control issues are dealt with on-the-spot long before the item is shipped out of China.
- Most trading companies, brokers and even manufacturers in China may not offer a warranty. We have the confidence to provide a full warranty on our workmanship because every assembly/inspection project utilizes an industry-leading, bi-lingual, ISO compliant, "Product Quality Manual (PQM)" which defines in intimate detail the quality standards, inspection methods and the assembly process.

Industry leading Product Quality System ensures expectations for quality are achieved and every product assembled by PassageMaker comes with a warranty. ISO 9001 registered and compliant.

Scalable & Flexible

The client has full visibility into the identity and pricing points of suppliers and sub-suppliers. Intellectual property and other sensitive client information are respected and protected.

PassageMaker will not unilaterally make changes (sub suppliers, raw materials, testing processes, equipment...) to the supply chain and assembly process.

Customer Service

PassageMaker's China-based account managers are native speakers of English, Spanish, French and Russian serving as a single point of contact for the client.

Customer Service

PassageMaker is in full compliance with local, national and applicable international standards for corporate social responsibility including workplace safety and environmental protection. You would be surprised how many factories dump scrap out their back door. We don't!

Every single employee enjoys a profit share system which is based on the individual's KPI (key performance indicators) and corporate performance.

- Overtime is not abused.
- Dorms are comfortable.
- Freedom of association.
- Skills training system in place.
- Non-discrimination.

Hiring based solely on the basis of the candidate's ability to do the job. We do not discriminate on the basis of age, gender, racial characteristics, sexual preference, maternity or marital status, nationality or cultural, religious or personal beliefs.

Find out how manufacturing in China can 'work' for you!

Today, China still ranks as one of the most cost-effective places to manufacture products, and it remains a viable option for foreign companies looking to maintain their competitive edge. We have taken it upon ourselves to showcase this fact to you by compiling **a new FREE whitepaper.**

"Staff and infrastructure costs in the US vs China: What brand owners need to know" presents readers with a concise breakdown of:

- Factory and Office Staff: Comparison of the US vs China
- China labor rates
- Work hours
- Mandatory benefits
- Taxes
- Employee severance
- Options for outsourced manpower and infrastructure