A CASE STUDY OF A SLOVAK SME POTENTIAL OFFSHORING TO CHINA

Master’s Thesis

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Abstract

Offshoring has become a popular business strategy in recent years. In general, China is the most attractive location thanks to its large low-cost labour market. Another factor attracting firms considering offshoring is its huge, constantly growing market. Most of the literature published today largely ignores size of the offshoring firms or focuses solely on large MNEs. Moreover, they explore firms already undertaking offshoring. In this thesis I investigate Ekom, a Slovak based SME, in early stage of decision-making about offshoring to China. Ekom’s main business activity is development and production of medical equipment. The thesis should serve both the academic and the practical purposes, in particular for further decision-making of Ekom’s managers about offshoring. I set the following research question: Should Ekom start offshoring production to China? To answer the question, I apply single-case study research design. I use data collected from interviews with the representatives of the company together with my own observation and secondary data. Also, I conducted a questionnaire aimed at revealing values of the company concerning offshoring. As offshore location is important for the decision about offshoring, I conduct brief country risks analysis of China, where I highlight key political, economic, operational and competitive risks. Thereafter I analyse three options, which Ekom has: 1. continuing at manufacturing in Slovakia, 2. establishing a captive center in China and 3. offshore outsourcing. Drawing on the literature review and my collected data I analyse the costs and opportunities arising from each of these three options. Consequently I compare the options in the light of the values of the company revealed by the survey and interviews. I adopt this approach because decision-making about offshoring is only in the initial phase and therefore, no exact data are available. Furthermore, the management of the company is more interested in qualitative rather than quantitative data at this point of the decision-making process.

I reach a conclusion that on the basis of the currently available information it is not possible to recommend a single option. However, taking all risks, costs and opportunities into consideration, manufacturing in Slovakia is the less risky option. Nevertheless, if Ekom’s management decides to run the risks of establishing a wholly owned subsidiary, captive offshoring could offer interesting opportunities, particularly cost reduction and access to the Chinese market. Offshore outsourcing fulfils Ekom’s
values the least. Therefore, Ekom could use services of an external supplier only for shorter term or only for offshoring simple, routinized tasks.
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1 Introduction

Economic growth of China has captured attention of firms with international ambition as well as international business researchers. China is the world’s second largest economy and the world’s most populated country. For many years it has been attracting foreign firms especially by its cheap labour force and a lot of them have invested in China to establish their own manufacturing facilities or outsourced their production to Chinese manufacturers. Though, China has been developing. Despite the fact that the income per capita is still low in comparison to developed countries, it has risen significantly in recent years. Middle class is growing, what drives the demand of the country. Therefore, many foreign firms have realised country’s enormous market potential. Moreover, regarding resources, China offers more than cheap labour today. Skills and education of the Chinese workers have improved and even the most sophisticated tasks including research and development may be performed in China.

Most of the research and case studies published on business activities in China have focused on big MNEs, eventually they have neglected the size of the firms. (Musso, Francioni 2012; Aspelund, Butsko 2010) Though, many studies show that SMEs¹ may significantly contribute to employment creation, economic growth as well as innovation and research and development. (OECD, 2013) In the most OECD countries, share of enterprises employing less than 20 persons is greater than 70 %. (OECD 2013) In the European Union, 99 % of all businesses are classified as SMEs, out of which 90 % are micro enterprises with less than 10 employees. They employ two of three private sector employees and create more than 50 % of total value added created in the European Union. (EC 2013) Moreover, almost one third of all European SMEs have been engaged in some sort of international business activities recently, mainly in exporting and importing, but some of them even invest in foreign markets or outsource their production. (EC 2011, p. 5) Various changing conditions at the macro and micro level contribute to the internationalization of SMEs. At the macro level they involve the emergence of common markets, decreased protectionist trade barriers or increased mobility of capital, technology and other resources. At the micro level, conditions contributing to internationalisation are associated with changing technology.

¹ According to European Union definition small and medium-sized enterprises are all enterprises “which employ fewer than 250 persons and which have either an annual turnover not exceeding 50 million euro, or an annual balance sheet total not exceeding 43 million euro.” (EC, p. 13)
communications and organisational forms, increased opportunities for SMEs to extend their value chains across border, changing business attitudes and managerial skills. (Johnson, Turner 2010) As the statistical data presented above show, SMEs play an important role in the economy. A number of them carry out international business activities abroad and due to the changing conditions of international business, the amount of these activities is likely to rise. However, the number of SMEs performing international business activities is still limited, especially because of the lack of financial and human resources. (e.g. Aspelund 2010, Buckley 1989) As a consequence, this area of international business literature remains to be explored only to a limited extent.

I think that entry of SMEs into the Chinese market is an interesting and relevant topic and I would like to explore this research area in this Master’s thesis. To investigate this area, I have chosen a Slovak-based SME, Ekom. It is a company focusing on development and production of medical equipment and thin sheet metal processing. The company currently employs about 200 employees. The main product of the company is an ecological oil-free compressor. Over more than 20 years of its existence Ekom has built a reputation as high-quality producer of compressors and accessories. It is an export-oriented company, exporting 99% of manufactured compressors to countries all over the world. The main market for Ekom’s compressors is the Russian market, the countries of CIS\(^2\) and the European market. Even though the demand in Europe is still high, managers of the company are concerned with the forgoing unrests in Russia and Ukraine. Besides, the competition in the industry rises and it is difficult to keep the high-quality while competing with companies manufacturing in low cost countries. Therefore, Ekom is considering offshoring part of its business operations to China. In the short-term view the company seeks to offshore some part of its production in order to reduce manufacturing costs. From the long-term perspective, Ekom’s objective is to increase its sales in the Chinese market. However, the directors of the company are dealing with the question, whether it is worth undertaking such a risk.

Thus, the main research question of my Master’s thesis is: *Should Ekom start offshoring production to China?* To answer the question, two subquestions arise. Ekom

\(^2\) Commonwealth of Independent States
may decide not to offshore and continue at the business as usual in the current site in Slovakia or they may decide to offshore. Moreover, if the company decides to offshore they must choose between the captive offshoring or the offshore outsourcing. Thus, Ekom has three options: 1. manufacturing in Slovakia, 2. captive offshoring and 3. offshore outsourcing. The first subquestion results from this: if Ekom decides to offshore, which offshoring mode, i.e. captive offshoring or offshore outsourcing, is more suitable? Second, what do the theoretical perspectives presented in the literature review suggest and what does my analysis of costs and opportunities suggest? My aim is to answer the questions on the basis of studied literature, interviews with Ekom’s managers, questionnaire and various secondary sources.

All in all, why is the thesis relevant? From academic point of view, it contributes to filling the gap in the literature on internationalisation of SMEs. (e.g. Aspelund, Butsko 2010; Musso, Francioni 2012; Peng 2001, Ruzzier et al. 2006) Moreover, most of the studies analyse firms based in the Unites States or Western Europe. There is a lack of literature on companies based in the countries of Central Europe, namely Czech Republic, Slovakia, Hungary and Poland. (Pawęta 2013) After dissolution of the Soviet Union, they were considered as transitive economies and researchers have investigated them as potential offshore locations. (Andreff 2008; Sass, Fifekova 2011; Meyer 2006) However, these economies have developed and international organisations categorise them as developed countries today. There are several companies in Slovakia which successfully internationalise and offshore their production to developing countries, including China. (Orfánus 2009; Finweb 2009; Ferenčák 2011; Žuffa 2015; Beracka 2015)

From practical point of view, I analyse a real case and I try to answer a real question for Ekom. My findings should serve further decisions of the company’s management. The decision to offshore or not may become one of the most important decisions in the existence of the company. By offshoring, Ekom could significantly reduce production costs, increase its production capacity as well as increase production and sales in the Chinese market. On the other hand, offshoring requires large investment and is associated with risk of “hollowing out” and loosing good reputation. In addition, working on this Master’s thesis is also a valuable practice for my future career.
The Master’s thesis is structured as follows. In this chapter I have introduced the thesis. The aim of the second chapter is to offer a review of the literature related to the topic of my thesis. It includes introduction to offshoring, insights of selected international business theories into the phenomenon, motives and risks of offshoring, factors influencing decision-making about offshoring and concludes with overview of the literature on offshoring of SMEs. Third, chapter on methods presents the main scientific methods I use and explains their relevance for the Master’s thesis. Concerning research design, the thesis is a single case study. I also present methods of data collection and methods of data analysis. It concludes with discussion of reliability and validity of my research.

Chapter 4 comprises the analysis of collected data. It starts with brief presentation of the company Ekom. Then I analyse China as a potential offshore location according to Lasserre’s country risk framework. Then I consider three options that Ekom has: continuation at manufacturing in Slovakia (1), establishing a captive center in China, i.e. captive offshoring (2) and outsourcing some business operations to an external service provider, i.e. offshore outsourcing. (3) I analyse costs and opportunities arising from each of these options partially applying real options reasoning. The final section of the chapter is devoted to the analysis of the options in the light of the values of the company. I conducted a survey concerning what is important for the company. I included values such as quality of products, protection of intellectual property, access to the Chinese market and others. Fifth part answers the research question and its subquestions, discusses the findings, comprises suggestions for further research and limitations of the Master’s thesis. Conclusion summarises findings.
2 Literature review

There is a plentiful literature related to offshoring, the main topic of this Master’s thesis. Offshoring is one form of internationalisation. (Schmeisser 2013) Therefore the following literature review draws on both the more general works on internationalisation as well as the more specific works on offshoring. The literature review starts with introduction to offshoring and explanation of its forms. Thereafter I provide insights of selected international business theoretical perspectives into the phenomenon, motives and drivers of offshoring, as well as challenges and risks which firms face when they offshore business activities. In the second section I address the decision-making about whether to offshore or not. I describe the theory of real options as a useful theory and a tool in the decision-making and further review literature on location and governance mode of offshoring as important factors influencing decision-making. The last section presents an overview of works on SMEs and internationalisation. It includes recent trends, motives and constraints of going international and offshoring. In the end I draw conclusions from the review of literature on aspects of offshoring relevant for my Master’s thesis.

2.1 Offshoring

Offshoring has emerged as an established business practice. (Jensen, Pedersen 2012; Oshri 2011, Maskell et al. 2007) The process of relocating business activities abroad has its origins in the late seventies of the last century. (Roza et al. 2011) The main force contributing to offshoring of business activities to other locations is globalisation. (Dou, Sarkis 2010) Liberalisation, deregulation of international trade, elimination of trade barriers, technological development in the field of information and telecommunication technologies and transportation as well as cost reduction in the use of these technologies have enabled firms to internationalise their value chains and offshore business operations. (Jensen, Pedersen 2012; Jensen, Pedersen 2007; Oshri 2011; Lasserre 2012; Farrell 2005)

2.1.1 What is offshoring

Literature offers a wide range of offshoring definitions. In general, offshoring, sometimes referred to as global sourcing, is a process by which companies relocate
some of their disaggregated organizational activities to offshore locations. (Bals et al. 2013; Aspelund, Butsko 2010; Jensen, Pedersen 2012) Another definition provides that offshoring involves “the disaggregation, relocation, and reintegration of activities and business processes across borders.” (Jensen et al. 2013; p. 352-353) Offshoring can be seen as a specific form of internationalisation. It mainly concerns input-market side rather than output-market side of the value chain. (Schmeisser 2013, p. 390) Offshoring is a broad term including both the internal mode, when the activities are implemented by wholly-owned subsidiaries and the external mode, when they are carried out by outsourcing partners. (Jensen et al. 2013; Oshri 2011)

Table 1 Global sourcing terms

<table>
<thead>
<tr>
<th>Location of production</th>
<th>Internalized or externalized production</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Internalized</td>
</tr>
<tr>
<td>Home country</td>
<td>Onshore sourcing</td>
</tr>
<tr>
<td>Foreign country (Offshoring)</td>
<td>Captive offshoring</td>
</tr>
</tbody>
</table>

Source: UNCTAD (2004); Pedersen et al. (2013)

Table 1 illustrates four forms of offshoring. It shows that the individual forms differ in two dimensions: (1) the location dimension, in other words, whether business activities are carried out in a home country or in a foreign country and (2) the ownership dimension, which says whether business activities are performed by external suppliers or wholly owned subsidiaries. For purposes of this Master’s thesis, it is important to distinguish between two modes of global sourcing - captive offshoring and offshore outsourcing. Both modes are used when business operations are relocated to an offshore location. Review of literature proposes that the term captive offshoring should be used when the operations are carried out by a wholly-owned subsidiary in an offshore location. (Oshri 2011, p. 32) Wholly owned subsidiaries set up overseas are also referred to as captive centers. According to Mol and Bertrand (2013) „offshore outsourcing refers to activities procured from independent suppliers located abroad.“ (p. 751) Besides, as a compromise between offshore outsourcing and captive offshoring, firms may set up a joint venture. (Bals et al. 2013; Aron, Singh 2005) To reap benefits from offshoring, firms should choose a mode fitting their business needs and the
decision should be based on a cost-benefit analysis of carrying out a business process in question at home. (Oshri 2011; Bals et al. 2013)

2.1.2 Offshoring in the Light of Selected Theoretical Perspectives

The phenomenon of offshoring may be perceived as a “new variation” of foreign direct investment. (Lewin et al. 2009) Therefore, various theories of foreign direct investment apply also to offshoring. In the following lines, I briefly explain core propositions of transaction costs economics, OLI paradigm, Uppsala model, resource-based view and institution-based view and provide insights of these theories into offshoring. Table 2 summarizes the core propositions of the theories and their relevance for offshoring.

Table 2 Theories summary

<table>
<thead>
<tr>
<th>Theory</th>
<th>Main propositions</th>
<th>Relevance to offshoring</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction costs</td>
<td>Firm strategy is explained by transaction costs</td>
<td>- offshoring governance mode decision</td>
</tr>
<tr>
<td>economics</td>
<td></td>
<td>- offshoring as way of transaction costs reduction</td>
</tr>
<tr>
<td>OLI paradigm</td>
<td>FDI is the most appropriate form of international business if the firm possesses</td>
<td>- decision whether to offshore or not</td>
</tr>
<tr>
<td></td>
<td>ownership advantages (O), location advantages (L) and internalization advantages</td>
<td>- decision about offshore location</td>
</tr>
<tr>
<td></td>
<td>(I)</td>
<td></td>
</tr>
<tr>
<td>Uppsala model</td>
<td>Firms increase their international involvement in incremental steps</td>
<td>- offshoring governance mode decision</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- psychic distance, offshore location</td>
</tr>
<tr>
<td>Resource-based view</td>
<td>Competitive advantage of the firm derived from the firm’s resources</td>
<td>- offshoring governance mode decision</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- offshoring as a strategy of acquiring new resources and capabilities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- offshoring as a core capability</td>
</tr>
<tr>
<td>Institution based</td>
<td>Institutions matter</td>
<td>- institutional environment affects decision to offshore, offshoring process</td>
</tr>
<tr>
<td>view</td>
<td></td>
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</table>

Although transaction costs theory was initially not designed as a theory of international business, it provides various insights into it and scholars widely use this
theory to explain different international business phenomena. (Verbeke, Greidanus 2009) The theory primarily explains why cross-border activities are organised within a firm, rather than within markets. (Forsgren 2008) Under lens of transaction costs economics, multinational firms are organisations which internalize markets across borders. A firm coordinates market activities, because markets fail to coordinate these activities efficiently. According to this theory, existence of a firm is a response to market failure, which is caused by transaction costs. (Teece 1986; Forsgren 2008) Thus, a firm can internalize certain economic activities to reduce high transaction costs. The theory assumes that different parts of economic operations must be located in different countries for efficiency reasons. (Forsgren 2008) Thus, cost reduction is the main rationale for offshoring in the light of transaction costs economics. Scholars apply this framework predominantly in the studies dealing with governance mode decision. (Schmeisser 2013)

For more than twenty years, Dunning’s OLI paradigm has been “the dominant analytical framework for accommodating a variety of operationally testable economic theories of the determinants of foreign direct investment (FDI) and foreign activities of multinational enterprises (MNEs).“ (Dunning 2000, p. 163) OLI framework has been also used to explain the offshoring phenomenon. (Aspelund, Butsko 2010) OLI paradigm argues that FDI is the most appropriate form of international business if the firm possesses ownership advantages, location advantages and internalization advantages. (Dunning 2000) According to Dunning, if a firm seeks to invest abroad, it should have ownership specific advantages, which means certain strategic asset that the other firms do not have. He argues that the greater the competitive advantages of the firm seeking to invest, relative to those of other firms, the more the firm is likely to expand internationally. The second part of the paradigm refers to location advantages. In terms of OLI paradigm, the more firms need to employ immobile, natural or created endowments tied to specific foreign locations jointly with their own competitive advantages, the more firms will choose to exploit or augment their ownership specific advantages through international production. Internalization advantages are the last component of the framework. It asserts that the greater the advantages of internalising cross-border intermediate product market, the more likely the firm will engage in foreign production rather than in licensing or using other market transactions. (Dunning
Furthermore, OLI framework parameters facing any specific firm and the response of the firm to that configuration depend heavily on the context. It rests on the economic and political environment of the home and host country, the type of industry and characteristics of the investing firm. (Dunning 2000)

The aim of the Uppsala model is to clarify internationalisation of a firm. (Johanson, Vahlne 2009) The core proposition of the theory is that firms increase their international involvement in incremental steps. To sum the model up, firms start their international business activities with exports and gradually begin to set up their own subsidiaries in the foreign market and they start to perform their international operations in countries with low psychic distance and gradually move to countries with larger psychic distance. (Johanson, Vahlne 2009; Ruzzier et al. 2006) With regards to offshoring, this perspective suggests that only firms with certain international experience should engage in offshoring. Moreover, selection of offshore location should be guided by psychic distance. (Aspelund, Butsko 2010) Although the validity of the Uppsala model has been proved in some studies, scholars have criticized the model for many weaknesses. (e.g. Chetty 1999) Many firms today do not internationalise gradually as the model suggests, but become international from their birth. Moreover, it does not sufficiently explain recent offshoring trends, such as why many European companies offshore to India or China with no or little international experience. (Manning et al. 2009)

Proponents of resource-based view argue that competitive advantage of a firm depends on its unique resource endowments. Scholars have proposed various attributes, which the resources should have to sustain a long-term competitive advantage. For instance, according to Barney (1991; 2011), a firm can sustain its competitive advantage of resources controlled by the firm if they are valuable, rare, inimitable and hard to substitute. Thus, resources may be either drivers of internationalisation through exploiting own resources as well as through accessing resources abroad or constraints to internationalisation, if they do not fulfil the criteria of being valuable, rare, inimitable and hard to substitute. Process or strategy of offshoring can be explained through resource-based perspective as a result of successful management of resources and it

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3 We provide more insights to psychic distance later in the text.
may be an example of direct use of firm-level capabilities. An ability to arrange, coordinate and organise offshored processes may become a core capability of some firms. On the other hand, firms can even acquire new core or additional capabilities or resources by offshoring and leverage their scarce firm-specific resources. (Doh 2005; Mohiuddin, Su 2008; Mudambi, Tallman 2010) Furthermore, resource-based view provides guidance to governance mode decision described later in subsection 2.2.3.

The above stated theoretical perspectives neglect the role of formal and informal institutions. (Peng et al. 2008) As researchers have increasingly confirmed that institutions matter in international business operations, institutional-based view has emerged. (e.g. Peng et al. 2008, Huett et al. 2014) It does not substitute but complements the leading international business perspectives. (Peng et al. 2008) Institutions may facilitate but also impede the process of relocation. (Mol 2007; Tate et al., 2007) Peng and Khoury (2009) formulated two key propositions of institution-based view:”(1) individuals and firms act rationally according to formal and informal institutional structures; (2) when formal institutions fail, informal institutions regulate exchange relationships.” (p. 1)

2.1.3 Motives and Drivers of offshoring

Offshoring can create large benefits for companies and even for whole economies. (Farrell 2005) What are the motives of firms to offshore? Scholars often state the same motives as in the context of foreign direct investment, which involve efficiency-seeking, resource-seeking, market-seeking and strategic asset-seeking motives. (Jensen et al. 2013) In general, companies offshore relatively simple, less advanced task to foreign locations, which offer them lower production costs or which have an abundant supply of resources used in the production. Thus, efficiency-seeking and resource-seeking motives are the main driving forces of firms’ decisions to offshore. (Jensen, Pedersen 2012) The four motives of offshoring are not mutually exclusive and a firm may decide to offshore for a combination of motives. For example, if a firm decides to relocate part of its operations to India, it may be motivated by highly skilled human resources as well as by cost savings. (Jensen et al. 2013) In conjunction with shift from prevalently efficiency- and resource-seeking motives to all four motives to offshore, the attributes of an attractive location for offshoring have changed as well. Besides abundance of resources and cheap labour force, important attributes involve
geographical location, access to knowledge and access to foreign markets. (Jensen, Pedersen 2012)

**Graph 1 Drivers behind Offshoring Decisions**

*Percentages of offshore activities surveyed by Offshoring Research Network with importance of strategic driver rated as 4 or 5 on a 5 points scale.*

![Graph showing the main drivers of companies’ decisions to offshore.](source)


*Graph 1* lists the main drivers of companies’ decisions to offshore, provided by Offshoring Research Network’s (ORN) survey. ORN is a global network of academic institutions and companies, which carry out research on offshoring phenomenon. (Lewin et al. 2009) The data reveal that cost reduction remains to be the main driving force. This is in accordance with transaction costs economics which claims that cost reduction is the main justification of offshoring. (Roza et al. 2011) This argument is supported by many studies, for example by Nachum and Zaheer (2005) or Pisani (2007).

However, due to further liberalisation of trade, economic reforms in emerging markets, improved intellectual property rights protection and improved supplier base in these markets, firms’ decisions are driven more by human resource-seeking and knowledge-seeking motives. (Jensen et al. 2013; Jensen, Pedersen 2012; Maskell et al. 2007) ORN data confirm this trend as the access to qualified personnel emerged as the third most important driver. Qualified labour force, together with business process
redesign and improved service levels may be perceived as resources and thus reflect resource-based view rationale for offshoring. (Roza et al. 2011)

Growth strategy ranks the fourth most important driver in the ORN survey. It may involve expansion of existing business activities as well as new market entry. (Massini et al. 2010) Roza et al. (2011) categorize this driver as an entrepreneurial driver. This category also includes increasing speed to market, differentiation strategy and access to new markets. Access to new market ranks at the bottom of the list. Therefore, market-seeking motives are only complementary, not the main motives for offshoring. Lewin et al. (2009) explain that offshoring is more related to sourcing than to sales activities and its aim is to support domestic or global, rather than local activities. (p. 902)

2.1.4 Challenges and Risks of Offshoring

Despite all the benefits emerging from offshoring, firms which make a decision to offshore, must face a number of challenges and risks. Empirical research points out that a lot of offshoring strategies fail. The reality often does not meet expectations of firms. Firms often have too high expectations in terms of benefits and underestimate the costs and risks associated with offshoring. (Jensen et al. 2013; Schroeder 2013; Deloitte 2008; Farell 2004) Therefore, the decision-making about whether to offshore or not, about the offshored activities and organisational structure should be based on expected risk-return trade-off of the specific offshoring operation. (Jensen et al. 2013)

Firms face a number of risks in the offshore locations. They usually emerge from differences in economic structures, policies, socio-political institutions, geography and currencies. (Johnson, Turner 2010) Scholars use different categories of risks in their studies. For instance, Hill (2012) distinguishes political, economic, and legal risks. Johnson and Turner (2010) use six categories of risks, namely economic risks, transfer risks, exchange-rate risks, location or neighbourhood risks, sovereign risks and political risks. Lasserre (2012) categorises risks as political, economic, operational and competitive risk. Researchers usually consider the same type of risks, differences are only in classification of these risks. In section 4.2 Country Risks Analysis I draw on Lassereˇs categorisation (see Graph 3). Thereafter, in the following paragraph, I explain different types of risks, which firms must deal with abroad, drawing on Lassereˇs categories.
Economic risks are results of changes in either the macro-economic or the micro-economic environment and may have negative effects on business performance. (Mcgowan, Moeller 2009; Lasserre 2012) They typically stem from changes in economic growth, inflation exchange rates or costs of inputs. (Lasserre 2012) Political risks may be defined as “any changes in the political environment that may adversely affect the value of firm’s business activities” (Griffin, Pustay 2015, p. 98), or „the impact of politics on markets.” (Bremmer 2005, p. 51) They generally arise from governmental action (Mcgowan, Moeller 2009) or other non-economic factors (Johnson, Turner 2010). They include risks such as wars, social unrests or expropriation (Lasserre 2012) and may have a large impact on firms investing abroad. (Bremmer 2005) However, in comparison to economic risk, they are difficult to measure and thus the literature on political risk mostly stems from empirical analysis and has conceptual character. (Click 2005) Competitive risks are caused by non-economic distortion of the competitive environment due to cartels, corruption or networks. Operational risks involve risks related to infrastructure and government regulations, such as high taxation, nationalistic preferences etc. (Lasserre 2012)

Offshoring is associated with higher complexity than when carrying all business processes at home. In general, firms face a number of risks in foreign markets. They usually emerge from differences in economic structures, policies, socio-political institutions, geography and currencies. (Johnson, Turner 2010) The offshoring locations and operations are associated with various degrees of political, economic, operational and competitive risks. (Lasserre 2012) According to Bals et al. (2013), firms must face six layers of complexity when engaging in offshoring. The layers include task complexity, structural complexity, operational complexity, social complexity, spatial complexity and outcome complexity. As a result of these complexities, it is difficult for the firms’ decision-makers to anticipate the consequences of offshoring. (Bals et al. 2013; Larsen et al. 2013) The increased complexity associated with offshoring results in a number of unanticipated or hidden costs and challenges. (Larsen et al. 2013)

When following the strategy of offshoring, firms must cope with different cultures, language barriers, accents and time zones. (Oshri 2011; Mehta et al. 2006) According to Lewin et al. (2009) and Mehta et al. (2006), however, the main challenges they encounter involve organizational structures and processes needed for coordination
of onshore and offshore business units and operations, knowledge management, location selection and human resources management at the offshore location. Kumar et al. (2009) conclude that two most important risks that offshoring pose include “the risk of losing skills key to competing for the future and the risk of making the offshoring decision at the least suitable time in the industry.” (p. 455) The ORN study reveals that the risk most often rated as high or very high is service quality. Other major risks perceived by companies include lack of cultural fit, loss of control, lack of client acceptance and lack of data security. (Graph 2) Interestingly, it concludes that there are no significant differences in the perception of risks by companies with offshoring experience and companies without the experience. (Lewin 2006)

**Graph 2** Perceived Risks of Offshoring

*Percentage of respondents who rated risks with 4 or 5 points on 5 points Likert scale.*

<table>
<thead>
<tr>
<th>Risk</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disaster recovery</td>
<td>26%</td>
</tr>
<tr>
<td>Political backlash</td>
<td>35%</td>
</tr>
<tr>
<td>Political instability in host country</td>
<td>39%</td>
</tr>
<tr>
<td>Intellectual property loss</td>
<td>39%</td>
</tr>
<tr>
<td>Infrastructure instability in host country</td>
<td>40%</td>
</tr>
<tr>
<td>Operational inefficiency</td>
<td>41%</td>
</tr>
<tr>
<td>Employee turnover in offshore service center</td>
<td>44%</td>
</tr>
<tr>
<td>Weakening employee morale</td>
<td>45%</td>
</tr>
<tr>
<td>Lack of data security</td>
<td>46%</td>
</tr>
<tr>
<td>Lack of client acceptance</td>
<td>49%</td>
</tr>
<tr>
<td>Loss of control</td>
<td>51%</td>
</tr>
<tr>
<td>Lack of cultural fit</td>
<td>54%</td>
</tr>
<tr>
<td>Poor service quality</td>
<td>61%</td>
</tr>
</tbody>
</table>


### 2.2 Decision-making whether to Offshore or not

In general, decision-making about whether to offshore or not is based on balancing the benefits and risks of relocating particular business activities to foreign locations. I provide academic insights into motives and risks of offshoring in the previous sections. In the following lines I briefly review literature, which concerns the decision-making about offshoring. In the two subsections I provide theoretical insights into location and offshoring mode as they are important factors in decision-making.
A case study of a Slovak SME potential offshoring to China

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(Dou, Sarkis 2010; Maskell et al. 2007) A useful tool in decision-making is the theory of real options, which I apply later in the Analysis. Therefore I address the theory in the first subsection.

Aspelund and Butsko (2010) assert that “knowledge, experience and information from business partners about the attractiveness of locations play an important part in the decision-making process.” (p. 72) Similarly, Maskell et al. (2007) demonstrate that experience is the core factor influencing the firms’ decisions. Moreover they propose that offshoring to low-cost developing countries is learning-by-doing process in which firms start to offshore simple task with the aim to lower the costs of production and in the next stages they increase the proportion of the offshored tasks and offshore more advanced tasks, ranging from administration, sales, to innovation.

In the following subsections I draw on the argument provided by Dou and Sarkis (2010) and Maskell et al. (2007), which stress the importance of location and „make-or-buy choice“ in the decision-making.

2.2.1 Theory of Real Options

I describe selected international business theories and their relevance for offshoring in subsection 2.1.2. Nevertheless, I devote a separate subsection to the theory of real options as it differs from the above mentioned theories. The theory may explain a wide range of international business issues, including decision-making whether to offshore or not and which organisational forms are the most suitable but scholars do not mention it as a typical international business theory. Besides, in comparison with the already described theories, the theory of real options is more a way of thinking about or analysing an international business issue, rather than developing propositions about offshoring. (Li, Rugman 2007; Li 2007; Eden 2009) The theory has its origins in financial options. (Li 2007; Krychowski, Quélin 2010) “Similar to financial options, real options are investment opportunities that confer the right, but not the obligation, to take some specific operating action in the future. These real options come into existence when existing resources and capabilities allow preferential access to future opportunities.” (Leiblen, Miller 2003, p. 843) Traditional research streams such as internalization theory or eclectic paradigm do not take the positive effects of uncertainty into consideration. Researchers applying transaction cost analysis claim that uncertainty increases the transaction costs and potential losses. Thereafter they propose how to
reduce the transaction costs. Real options theory offers a new perception of uncertainty in international business literature. Uncertainty may pose not only risks but also potential opportunities in the future. Therefore, firms may benefit from uncertainty and they should prepare real options if they want to be flexible in decision-making and responding to opportunities and challenges. (Li, Rugman 2007, Li 2007)

In comparison with financial options, real options rest on real assets, they are frequently non-tradable, their value is influenced by managers’ actions and they are often implicitly embedded in strategic investments. (Li 2007) Right to sell or buy a financial asset in the future represent financial options. An example of real option is a decision to establish identical factories in two countries, and thus the owner may enjoy the right to transfer manufacturing between these two factories, if there are any uncertainties such as political turmoil or currency fluctuations. (Mol 2007) The theory focuses on the value of investments “that allow firms to manage risk proactively by confronting uncertainty over time in a flexible fashion.” (Leiblen, Miller 2003, p. 843) Two conditions shall be met in order to determine whether a strategic investment in a project offers real options. First condition is associated with “volatility regarding future payoffs of the project” and the second is related to “managerial flexibility in increasing commitment or controlling losses according to the resolution of uncertainty in the business environment.” (Li 2007, p. 70)

Real options theory has been applied to explain a number of international business phenomena including offshoring. (Li, Rugman 2007; Li 2007; Eden 2009; Desbordes 2007) There are two streams of literature employing real options- first use real options as interpretative lens, second as a decision framework. Out of these two streams, the second is relevant for this thesis. It can facilitate to evaluate and structure the opportunities arising from decision under uncertainty. Real options may be applied as real options valuation or real options reasoning in the decision-making. (Krychowski, Quélin 2010) The literature provides a range of complex real options valuation models. (Copeland, Keenan 1998) However, due to lack of information to make use of the models, I apply real options reasoning in my analysis. Many scholars apply it as a way of thinking or as a rhetorical tool. (Krychowski, Quélin 2010; McGrath, Nerkar 2004)

For example, Antelo and Bru (2010) argue that outsourcing may be seen as a real option for the firm, which offer an opportunity to adapt to future information. They
analyse a restructuring process of a firm and they conclude that in this process, outsourcing may be a real option. It delays the restructuring process, while new information about the value of restructuring may be obtained in the future. Later, the firm may decide whether the processes will be outsourced permanently or temporarily. Real option frameworks also provide guidance in deciding which activities to offshore and which not. For instance, Alvarez and Stenbacka (2007) study this problem and draw a conclusion that with increasing market uncertainty, the adoption of outsourcing strategy is postponed.

Although the theory is complex and allows clarifying a number of international business subjects, its application has been limited so far. On one hand, it takes time to apply all the rapid and diverse advances in the modelling and solution techniques in research. (Li 2007) On the other hand, a firm must be able to collect all needed information to determine at which point of time it should optimally exercise the option. Even when a firm has all the necessary information, though, there may be organizational constraints hindering flexibility in exercising the option. (Mol 2007)

2.2.2 Offshoring Location

In all decisions firms make about internationalisation, location remains to be an important factor. It is an important variable affecting global competitiveness of firms and should not be neglected. (Dunning 1998) Success or failure of offshoring is determined by choice of offshore location as well. (Aron and Singh 2005; Jensen and Pedersen, 2011.) As I have already mentioned in the text, Ekom company is considering whether to offshore to China or not. Although the location is already determined by the company, the question remains whether China is suitable location fitting the company’s strategy.

Various strands of literature assert that location preferences of firms depend on their motives of foreign investment, thus whether they are resource-seeking, market-seeking, efficiency-seeking or strategic asset-seeking. (Dunning 1998) For example, Jensen and Pedersen (2011) group important attributes of offshore destinations into four categories – cost levels, human capital, business environment and interaction distance between onshore and offshore location. Their findings show that choice of location should depend on the fit between the attributes of the offshoring location and the attributes of the offshored processes. In addition, distance between home country and
offshore location is an important factor influencing decision to offshore to a particular location and success of the decision.

2.2.2.1 Distance

“Even in the contemporary era of advanced communications technology and enormous international trade, senior managers still need to take into account “distance” when assessing host country location advantages in culture, societal institutions, physical location and economic status.” (Verbeke 2009, p. 129) The role of distance should not be neglected when making decisions about offshoring. (Schmeisser 2013; Jensen et al. 2013; Kumar et al. 2009; Ceci, Prencipe 2013) In the context of international business literature, the term distance does not only mean geographic separation but has more dimensions. Ghemawat (2001) uses four basic dimensions: cultural distance, administrative distance, geographic distance and economic distance.

Cultural distance arises from differences in cultural attributes such as language, religious beliefs, social norms and race. (Ghemawat 2001) Administrative distance, also referred to as political or institutional distance, results from differences in societal institutions. This dimension of distance is lower if countries share a common history, have political ties, have engaged in economic or monetary integration or preferential trading arrangements. As a consequence of this dimensions, different countries apply different tariffs, restrictions or regulations and accept different levels of corruption. (Verbeke 2009) In general, geographic or spatial distance is the physical distance between countries. However, when analysing geographic distance, other factors should be considered as well, including transportation and communications infrastructure, topography, access to waterways, ocean and physical size of the country. (Ghemawat 2001) Economic distance is the result of differences in economic attributes. For example, cost and quality of natural, financial and human resources as well as prevailing business practices affect the economic dimension of distance. (Verbeke 2009) The four dimensions of distance have impact on industries in different ways. For instance, products or services that have high linguistic contents are more likely to be exposed to cultural distance than standardized industry machinery. (Ghemawat 2001)

Ghemawat (2001) argues that the higher the distance composed of all four dimensions, the lower the inter-country trade levels. Furthermore, firms often overestimate attractiveness of a foreign location and do not take into account costs and
risks related to distance. He asserts that the higher the distance of a country as a possible location for business operations, the lower the probability of success. Verbeke (2009) criticises Ghemawat’s approach for several reasons. He claims that firms may develop new capabilities in originally distant locations and thus can overcome distance barriers. Similarly, cooperative entry modes, such as joint ventures or strategic alliances may soften the effects of high distance. Moreover, he suggests that Ghemawat’s framework is valid only for firms which seek to transfer their firm-specific advantages.

Several authors have studied the impact of distance between the home and offshore location on offshoring, how distance impedes or stimulates relocation of business operations and effective performance of the offshore operations. (Jensen et al. 2013) Kshetri (2007) examines the relationship between perceived cultural distance and firm’s offshoring decisions. He concludes that low cultural distance between home and host country is likely to be positively related to the amount of offshored activities between these two countries. Moreover, the higher the distance the higher are hidden costs of offshoring. (Ceci, Prencipe 2013; Stringfellow et al. 2008; Dibbern et al. 2008) Many scholars have pointed out that with increasing distance the costs of coordination and communication rise. (e. g. Ceci, Prencipe 2013) As a result the relocation of business operations to foreign locations with heterogeneous cultures and institutions requires new and ad hoc organizational practices. Besides, Dibbern et al. (2008) find that cultural and geographic distance impede effective transfer of knowledge and control in the organization.

Another term widely used in international business literature is psychic distance. The term has its roots in Uppsala internationalisation school that defines the psychic distance as “factors preventing or disturbing the flows of information between firm and markets” (Johanson, Wiedersheim-Paul 1975, p. 308) These factors range from differences in language, culture, level of education and political systems to differences in industrial development. (Johanson, Vahlne 1977, p. 24) The Uppsala internationalization scholars argue that firms tend to select foreign markets depending on their psychic distance from the home country. Therefore, the lower the psychic distance from a particular firm, the higher is the probability that a country is selected by the firm. (Johanson, Wiedersheim-Paul 1975) Psychic distance is still relevant and it influences selection of markets. For example, Brewer (2007) constructs an index
measuring psychic distance and provides evidence that there is a strong, negative correlation between the psychic distance index and selection of export markets. In addition, SMEs face a number of risks arising from foreignness. Expanding first to countries with lower psychic distance is one way of minimising these risks. (Buckley 1989)

All in all, results of international business scholars show clear evidence that the distance matters. Thus, benefits of relocating activities to a specific location depend not only on location-specific factors but also on the location’s distance to the home country. (Blanc-Brude et al. 2014) Especially, perceived distance influences the decision of firms whether to offshore to a particular location or not. (Kshetri 2007; Johanson, Vahlne 1977; Johanson, Wiedersheim-Paul 1975)

2.2.3 Captive Offshoring vs. Outsource Offshoring

As I mention above, captive offshoring means relocating production of a product or service to a foreign country by establishing a wholly-owned subsidiary abroad. (Oshri 2011, p. 32) Offshore outsourcing refers to implementation of activities by an external supplier. (Oshri 2011; Bals et al. 2013; Mol, Bertrand 2013) Transaction cost economics as well as resource-based view suggest rationale behind governance decision, i.e. whether the transactions should be internalised or externalised. In other words, these theoretical frameworks provides insights when should the companies choose captive offshoring and when offshore outsourcing. (Jensen, Pedersen 2012; Jensen et al. 2013) In the following lines I draw from the introduction to the theories contained in section 2.1.2.

In terms of the resource-based perspective, firms should concentrate on those activities which are their core competencies and strategically outsource the other activities. (Prahalad, Hamel, 1990; Quinn, Hilmer 1994) In other words, if an activity does not contribute to sustainable competitive advantage, it is reasonable to outsource the activity. (Mudambi, Venzin 2010) Following this strategy firms may reap benefits in four ways. Firstly, they can significantly increase its returns on internal resources. Secondly, well-developed core competencies protect a firm against present and future competitors. Thirdly, firms may fully utilize investments, innovations and specialized capabilities of external suppliers. Lastly, firms may lower risks and investment, make cycle times shorter and better respond to customer demands. (Quinn, Hilmer 1994)
Asset specificity and uncertainty stand in the center of transaction cost reasoning. Asset specificity “refers to transferability of an asset to alternative uses.“ (Jensen, Pedersen 2012; p. 318) High asset specificity means that it is difficult to transfer the asset to other types of usage. The theory implies that when asset specificity and uncertainty is high, there is higher risk of knowledge leakage and firm should internalize the transaction and decide for captive offshoring. On the other hand, when asset specificity and uncertainty are low, transactions should be externalized and offshore outsourcing is a better option. (Jensen, Pedersen 2012, p. 318; Mohiuddin, Su 2008)

Furthermore, motives and nature of the offshored tasks have often impact on governance mode decision. Firms driven by efficiency-seeking motives generally offshore relatively simple, standardized and routinized tasks. Then they tend to outsource the tasks. On the other hand, human resource-seeking and knowledge-seeking firms tend to choose captive offshoring mode with higher degree of internalization. (Jensen et al. 2013, p. 318)

Moreover, when comparing offshore outsourcing and captive offshoring, offshore outsourcing means loss of control over the outsourced business processes. The process of offshore outsourcing also implies that the firm must rely on future collaboration with foreign suppliers for future potential innovation processes. Further, firm performance is dependent on the ability to deal with increased distance to the suppliers. (Maskell et al. 2007; p. 240) Firms which relocate business processes to wholly owned subsidiaries abroad face similar challenges as firms using an external supplier. Though, establishing a captive center may be more challenging, because it requires high risk management, higher investment and acquisition of new skills among other things. (Oshri 2011, p.35)

Aron and Singh (2005) put forward that decisions about organisational structure of offshoring should rest on the extent on operational (defined as “the risk that processes won't operate smoothly after being offshored”; p. 138) and structural risk (defined as “the risk that relationships with service providers may not work as expected”; p. 138). When the both types of risks are low, firms can outsource business activities to external service providers. On the contrary, when both are high, neither captive offshoring nor offshore outsourcing is feasible. The authors further suggest that when structural risk is very high, establishing captive centers appear to be a better
option. When operational risk is high, setting up local captive center is the most appropriate solution. Compromise between offshore outsourcing and captive outsourcing is establishing a joint venture. (Aron, Singh 2005)

2.3 SMEs and offshoring

SMEs play an important role in economy. They represent the majority of the total number of businesses in most of the countries and significantly contribute to employment and growth of economy as well as may generate growth by widening their international activities. (OECD 2013; EC 2013) Though, most of the literature on internationalisation has been published on large MNEs (e.g. Aspelund, Butsko 2010; Musso, Francioni 2012; Peng 2001, Ruzzier et al. 2006) or ignores the size of the firms assuming that findings are widely applicable to firms of all sizes. However, as I suggest in the text below, size of the firms matters and implies various advantages and disadvantages for offshoring.

2.3.1 Drivers and Motives of SMEs´ Internationalisation and Offshoring

Many SMEs have successfully undertaken international activities beyond their home markets. (e.g. Ruzzier et al. 2006; OECD 2013; EC 2013) There are several drivers contributing to this trend. First of all, developments in transportation, telecommunication and information technology have decreased the transportation costs, facilitated and offered easier access to information. In addition, system of business education has internationalised and availability of managerial talents with international experience is increasing. (Aspelund, Butsko 2008; Johnson, Turner 2010) Moreover, macro-level conditions including emergence of common markets, decreased trade barriers, increased mobility of capital, technology and other resources also facilitate international business activities of SMEs. (Johnson, Turner 2010) All of these factors have made internationalisation as well as offshoring easier and have lead to increased competition on the international level. This forces firms to take the risks of foreign markets and exploit advantages and opportunities which these markets offer. (Aspelund, Butsko 2008; Ruzzier et al. 2006)

Besides, the experience of many large MNEs shows that large size of a firm does not guarantees a success. (Johnson, Tellis 2008) In comparison with large MNEs, SMEs
possess a number of advantages. These include low bureaucracy (Johnson, Tellis 2008; Johnson, Turner 2010), creativity and innovative thinking, (Ferreira et al. 2013; Johnson, Turner 2010), ability to adapt to changing market conditions (Johnson, Turner 2010, Roza et al. 2011), ability to take risks (Roza et al. 2011), flexible decision-making or flexible cost structure (Johnson, Turner 2010).

In the text above I mentioned factors that contribute to the increased internationalisation of SMEs. What is the main motivation of SMEs to set up an operation overseas? Researchers claim that SMEs have the same motives as large MNEs, namely market-seeking, resource-seeking, and efficiency-seeking (Buckley 2008). Some authors argue that there are also other motives besides these, such as innovation-seeking (Meyer, Peng 2011), but they may be considered only as a subcategory of the three generally presented motives. These motives of establishing foreign subsidiaries are not mutually exclusive and firms can follow several goals in their strategy. (Meyer, Peng 2011) Research shows that applying the strategy of offshoring, SMEs can cut costs, gain access to resources, expand their networks and serve clients more effectively, what contribute to better international competitiveness. (Gregorio et al. 2009)

2.3.2 Constraints of SMEs’ Internationalisation and Offshoring

When comparing internationalisation options of SMEs with those of large MNEs, SMEs face a number of constraints. These barriers of internationalisation are valid also for offshoring. There are a number of approaches to categorizing these constraints. Literature (e.g. Buckley 1989; Johnson, Turner 2010) distinguishes internal and external constraints. Internal constraints reflect how inadequacies within the firm constrain the international business activities. They refer to the lack of internal resources, such as lack of capital, management and information. External constraints include institutional restraints, such as trade restrictions, bureaucratic procedures and constraints arising from market and from the threat of being taken over by another form. (Buckley 1989; Johnson, Turner 2010)

Financial and management constraints are the most often stated constraints which SMEs must cope with. (Buckley 2008; Buckley 1989; Musso, Francioni 2012; Ferreira 2013; Johnson, Turner 2010; OECD 2009, Huett et al. 2014) SMEs often have lack of capital for performing international activities. Setting up a subsidiary and even
exporting is often unrealistic due to the shortage of financial resources. (Hessels, Parker 2013; Roza et al. 2008; Buckley 1989, 2008) Besides, SMEs often face a ‘catch-22’ problem - how to raise finance without disclosing information about competitive advantages, particularly its intellectual property. Moreover, owners of SMEs often want to retain control, in many cases family control, what makes capitalization even more difficult. Often more serious problem is lack of skilled management. (Buckley 2008; 1989) Firstly, SMEs often do not have managers to manage their international operations. Secondly, decision-making process is likely to be based on personal decisions without an appropriate evaluation of possible alternatives. Smaller firms have neither financial nor human resources to evaluate potential locations or entry modes. (Buckley 2008; Aspelund, Butsko 2010) Besides, other barriers arise from contractual and technological factors. Smaller firms usually try to minimise transaction costs, thus they are often not willing to undertake the risk of expansion and diversification. They often rely on one product and one market. Thus, they are more vulnerable to any changes including technological changes, which can have adverse effects on their growth. (Buckley 1989) Moreover, barriers to internationalisation of SMEs arise from organisational issues. (Aspelund, Butsko 2008; Buckley 1989) Achieving a balance between hierarchical control and cooperation is often a problem. Choice of the chief executive of the new foreign subsidiary may serve as an example. (Buckley 1989)

As a consequence of various barriers, it is more difficult for SMEs to handle the complexity of international operations and therefore they are often passive towards international activities. (Ferreira 2013) Recent report by European Commission (2010) studied European SMEs and its results show that the most important barriers for international activities are price of their own product or service, high cost of internationalisation, lack of capital, lack of adequate information, lack of adequate public support and the costs of or difficulties with paperwork associated with transport. As a result of limited resources, SMEs face a high degree of risk when they go international, in particular when they seek to produce in a foreign location. One of the reasons for this is that they usually use higher proportion of resources to a single foreign investment than larger firm. (Buckley 1989) Their competitiveness often relies on firm-specific resources and SMEs’ generally suffer from liabilities of smallness. (Huett et al. 2014) Moreover, there is a negative correlation between firm size and risks related to
FDI. (Kuo, Li 2003) A number of studies conclude that SMEs undertake particular risk when transferring the firm-specific resources abroad and must deal with risks arising from host countries environment. (e.g. Huett et al. 2014; Nakos, Brouthers 2002; 2004)

2.4 Conclusions of Literature Review

In conclusion, offshoring may be used by firms as a strategy to remain competitive in the global environment. Various theoretical perspectives provide insights into offshoring phenomenon out of which transaction cost economics and resource-based view are the most often applied. (Aspelund, Butsko 2010) Transaction costs economics view offshoring as a strategy to reduce manufacturing costs. (Teece 1986; Forsgren 2008) Resource-based view considers offshoring as a strategy of acquiring new resources. (Doh 2005; Mohiuddin, Su 2008; Mudambi, Tallman 2010) In compliance with these perspectives, international business scholars demonstrate that efficiency-seeking and resource-seeking motives are the most important motives to relocate business activities to an offshore location. (Nachum, Zaheer 2005; Pisani 2007; Lewin et al. 2009; Roza et al. 2011; Jensen et al. 2013; Jensen, Pedersen 2012; Maskell et al. 2007) However, firms which decide to offshore, must face a number of risks and challenges. One of the highest risks is poor performance of a particular business operation in the offshore location. (Kumar et al. 2009; Lewin 2006; 2009) Other risks and challenges include lack of cultural fit, loss of control over the offshored operation, lack of client acceptance etc. (Lewin 2006) As a consequence, firms must frequently cope with increased coordination costs and various hidden costs. (Kumar et al. 2009; Larsen et al. 2013; Mehta et al. 2006)

Decision-making about whether to offshore or not should rest on balancing benefits and risks of offshoring. Moreover, it is influenced by experience, knowledge and available information of the firm. (Aspelund, Butsko 2010; Maskell et al. 2007) In connection with decision to offshore, location and organisational structure of offshoring are important. Although Ekom has already selected the location, its fit with the offshoring strategy should still be assessed. (Jensen and Pedersen 2011; Dunning 1998) Besides, distance in all its dimensions, including psychic distance should be taken into consideration as large distance may lead to increased costs of offshoring and worsen the effectiveness of the strategy. (Schmeisser 2013; Jensen et al. 2013; Kumar et al. 2009;
After decision to offshore, a question arises, whether to establish wholly owned subsidiaries or offshore production to external service providers. Scholars suggest that there are plentiful factors, which shall be taken into account, involving the importance of the offshored activities for sustaining competitive advantage (Mudambi, Venzin 2010; Prahalad, Hamel, 1990; Quinn, Hilmer 1994), asset specificity and uncertainty (Jensen, Pedersen 2012; Mohiuddin, Su 2008) and risks of the offshored activities. (Aron and Singh 2005)

After reviewing the literature on offshoring, I can conclude that there is a lack of studies on offshoring by SMEs. Globalisation has significantly contributed to an increased number of SMEs undertaking offshoring strategy in recent years. (Aspelund, Butsko 2008; Johnson, Turner 2010; Ruzzier et al. 2006) Similarly as large MNEs, SMEs are driven by market-seeking, resource-seeking, and efficiency-seeking motives. (Buckley 2008) However, SMEs must face a number of external and internal constraints. (Buckley 1989; Johnson, Turner 2010) Financial and management constraints are considered to be the most common constraints. (Buckley 2008; Buckley 1989; Musso, Francioni 2012; Ferreira 2013; Johnson, Turner 2010; OECD 2009, Huett et al. 2014) As a consequence of these constraints, SMEs are often unwilling to undertake the risks of offshoring. (Huett et al. 2014; Nakos, Brouthers 2002 Ferreira 2013)

In conclusion, there is not a single theoretical perspective providing a clear answer to my research question. I have not found any similar case study analysing a firm of similar size in early process of decision-making about offshoring. However, all the scientific works cited in this chapter are relevant for Ekom’s case and provide background for further analysis.
3 Methodology

In this chapter I provide key research approaches applied in the Master’s thesis. I apply a case study research design. First, I explain theoretical insights into case studies as well as introduce the case study research used in this thesis. Second, I present the methods used for data collection, mainly observation, interviews, survey and collection of secondary data. Third, I explain how I analyse the collected data. And finally, I discuss reliability and validity of this Master’s thesis.

3.1 Case Study

The main research method is case study. Case study is widely used as a research method in a number of scientific disciplines, such as psychology, political science, sociology but even business and economics. (Yin 2009) The research method is suitable to explore new phenomenon that is little understood. (Hartley 1994) There is no single definition of a case study. For instance, Yin (2009) provides twofold definition. The first part is related to the scope of case study. „A case study is an empirical inquiry that investigates a contemporary phenomenon in depth and within its real-life context, especially when the boundaries between phenomenon and context are not clearly evident.“ (p. 18) In the second part he defines technical characteristics of case studies. „The case study inquiry (1) copes with the technically distinctive situation in which there will be many more variables of interest than data points, and as one result; (2) relies on multiple sources of evidence, with data needing to converge in a triangulating fashion, and as another result; (3) benefits from the prior development of theoretical propositions to guide data collection and analysis.“ (Yin 2009; p. 18, numbers added) According to Easterby-Smith et al. (2012), ”the case study looks in depth at one, or a small number of organisations, events or individuals, generally over time.” (p. 54) Woodside (2010) proposes that the aim of case study research is usually description, understanding, prediction or control of an individual case, or any combination of these. Yin (2009) claims that the rationale for case studies stems from the desire to understand complex social phenomenon. (p. 4)

Despite the fact that case studies are frequently applied in many research areas, case study as a research method is often target of criticism. First, there is a concern over the lack of rigour. Second, case studies are criticised as they do not provide appropriate
basis for scientific generalisation. Third, objections are made as the result of a case study research is often a lot of data, which allow various interpretations. (Yin 2009, Easterby-Smith et al. 2012) On the other hand, case study has several advantages. It enables to study a social phenomenon in depth and explore the process of change. Furthermore, it is flexible, meaning that it is neither constrained by time nor by method. (Simon 2009)

Literature distinguishes between several types of case studies on the basis of their design. The main differentiation is made between single-case study and multiple – case study. In this Master’s thesis I apply single-case study design. It allows studying the given phenomenon in depth. (Mills, Durepos 2013) Yin (2009) lists five rationales for single-case study. It is an appropriate design, when the case is a critical case in testing a well-formulated theory (1), when it is an extreme or unique case (2), when it is the representative or typical case (3), when it represents the revelatory case (4) and when it is the longitudinal case (5) (p. 47, 48)

The unit of single-case study analysis is Slovak medium-sized company Ekom. Out of the five rationales, the second is the most relevant to justify choice of single-case study as the main research method in this Master’s thesis. A medium-sized company from Slovakia considering offshoring to China is a unique case in Slovakia. However, other rationales support the choice of single-case study design as well. As stated in the Introduction, one of the leading questions concerns theoretical perspectives. More specifically, how they contrast with my findings. Thus, the case has an element of being a critical case. Also, there is a weak longitudinal element in the case study. I analyse and draw conclusions about the company on the basis of studying Ekom since its establishment that was more than 20 years ago. In addition, practical need is another motive of conducting a single-case study. The thesis should serve as a supporting material for further decision-making of Ekom’s managers. All in all a single-case study method allows me to study the case of Ekom in depth and allows me to use various methods for data collections, such as observation, interviews, questionnaires as well as secondary data collection.
3.2 Data Collection

The data collection procedures should reflect the research question and the choice of design. (Meyer 2001) In my research I use combination of interviews, questionnaires and observation as well as secondary data available in Ekom’s internal documents and data available in internet resources, such as journals, magazines and databases. This triangulated methodology (Meyer 2001, Yin 2009) allows for stronger justification of findings. However, I acknowledge that even more methods and more interviews or questionnaires could be made, but choice of data collection method and the scope of my research were limited by time and financial resources. In the following lines I describe the chosen methods of data collection.

3.2.1 Interviews

Interviews were source of further primary qualitative data. According to Easterby-Smith (2012), interviews are the main method “to gain insights into the social and organisational realities.” (p. 126) Interviews enabled me to gain insights into Ekom’s values, opinions of individuals, organisation of the company and to obtain other important information, which is not included in their secondary sources.

According to the level of structure, literature distinguishes among the following three types of interviews: highly structured interviews (1), semi-structured interviews (2) and unstructured interviews (3). (Easterby-Smith et al. 2012) Although highly structured interviews have the advantage of high degree of standardisation of questions and answers, my aim was to achieve more personal replies with higher degree of confidentiality, therefore I used more less-structured interviews.

Before conducting the interviews I prepared guiding questions. (see Annex I) In line with Easterby-Smith’s recommendations (2012) I used the laddering technique in order to gradually reveal more and more information from the respondents. Also, to avoid bias, I tried to ask open questions. Naturally, not all required information were possible to gain through open questions, therefore I asked close questions as well.

One interview was conducted per Skype when I was in Copenhagen. The aim of the interview was to develop a research question for this Master’s thesis. All the other interviews were conducted in person at Ekom’s offices in Piešťany, Slovak Republic. In the interviews I used Slovak language, as it is native language of the respondents. Using
Slovak, I avoided potential language barriers and could lead confidential conversation. The interviews were not recorded as the interviewees did not wish to be recorded. This did not cause any difficulties, as they suggested me to ask again per e-mail if I had missed any information. I took brief notes during the interviews and wrote summaries immediately after finishing the individual interviews. The following table comprises the basic information about the interviews. I do not include names of the respondents, as they asked me not to disclose their names. Thereby, I state only their position in the company. I interviewed both directors of Ekom, the Production and the Commercial Director, as they could offer me the most valuable information and the decision whether to offshore or not, will rest heavily on their decision. Furthermore, I interviewed two junior managers as these are expected to be in the top management in the future, therefore their perceptions and opinions about Ekom are relevant for this case study as well.

### Table 3 Interviews

<table>
<thead>
<tr>
<th>No.</th>
<th>Date</th>
<th>Position</th>
<th>Form</th>
<th>Duration</th>
<th>Topical Focus</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>10-12-2014</td>
<td>Production director</td>
<td>Skype</td>
<td>ca. 45 min.</td>
<td>Research question development</td>
</tr>
<tr>
<td>2</td>
<td>12-3-2015</td>
<td>Production director</td>
<td>In person</td>
<td>ca. 60 min.</td>
<td>Ekom’s vision and values, offshoring</td>
</tr>
<tr>
<td>3</td>
<td>17-3-2015</td>
<td>Junior Manager A</td>
<td>In person</td>
<td>ca. 40 min.</td>
<td>Ekom’s vision and values, offshoring</td>
</tr>
<tr>
<td>4</td>
<td>17-3-2015</td>
<td>Junior Manager B</td>
<td>In person</td>
<td>ca. 20 min.</td>
<td>Ekom’s vision and values, offshoring</td>
</tr>
<tr>
<td>5</td>
<td>19-3-2015</td>
<td>Commercial director</td>
<td>In person</td>
<td>ca. 30 min.</td>
<td>Ekom’s vision and values, offshoring</td>
</tr>
</tbody>
</table>

#### 3.2.2 Observation

Observation is a widely used method in organisational and management research. (Easterby-Smith et al. 2012) This method offers a number of advantages. It can be carried out without any direct interaction with participants and is unobtrusive. (Meyer 2001) “When the researcher has access to group processes, direct observation can illuminate the discrepancies between what people said in the interviews and casual conversations and what they actually do.” (Pettigrew 1990, cited in Meyer 2001 p. 331-340)
There are four types of participant observations: complete participant, participant-as-observer, observer-as-participant and complete observer. (Easterby-Smith et al. 2012, Meyer 2001) I acted as the first two types of observers. I took an internship in Ekom Company during the time of writing Master’s thesis. Most of the people I observed knew that I was writing my Master’s thesis about Ekom, but some people did not. Therefore, sometimes I was in the role of the complete observer, concealing my intention to study and observe the setting. Though, in most situations, I acted as the participant-as-observer building relationships and participating in the context, without concealing my intention to observe the setting.

Based on recommendations of Adams et al. (2007) I documented my observations into a research diary. My observations and taken notes helped me to understand the values and culture of the company. Besides, being a part of the company enabled me to ask informal questions in addition to the interviews. Also, my observations were helpful when preparing guiding questions for interviews.

3.2.3 Secondary data

Besides primary data, I used secondary data such as newspaper articles, magazine articles, journal articles and websites as well as well as Ekom’s annual report, official presentation, video and other documents provided by the company. The main advantage of the secondary data is that their collection saves time and researcher’s effort and there are plenty of high-quality data sources. (Easterby-Smith et al. 2012) Besides, the secondary data helped me to prepare for the interviews and to prepare the questionnaire.

3.2.4 Survey

I conducted a survey in the form of a questionnaire. Surveys belong to frequently used tools in business and management as a method of data collection. (Adams et al. 2007; Easterby-Smith et al. 2012) In general, the main purpose of questionnaires is to make statistical inferences. I used the questionnaire (see Annex II) to discover the core values of the company as seen by the key individuals in order to suggest the best option regarding offshoring. I did not use the results for statistical analysis as the survey was conducted only among a small number of respondents. Besides, my objective was not to get precise numbers but to find out what is important
for the future of the company and how it fits the considered offshoring strategy. By carrying out a survey, I could get unbiased answers of the respondents without any influence of me, the interviewer, or of other individuals working in the company. In the Chapter Analysis I discuss three options that Ekom has – continuing in production in the home country, captive offshoring and offshore outsourcing. As seen from the literature review, there are different opportunities and costs arising from each of these options. In the first step of decision-making about offshoring it is important to consider the options in the light of the key values of the company. Although I could ask about the values in the interviews, my aim was to get the unbiased answers. Therefore I decided for a questionnaire.

Albeit scholars recommend having higher rate of respondents, my survey was intended to reveal only the perceptions of the key individuals. I handed in the questionnaires via e-mails. I sent the questionnaire only to four persons I made interviews with. These persons will be the most influential in the decision-making about offshoring. Ekom has six partners, who have been working for the company from the establishment until today. As they have maintained very good relationships over the years, Ekom resembles a family-run business. Hence, the values of the key individuals are very important for the future of the company. Moreover, prior decision-making about important issues was usually also based more on qualitative analysis of the facts and “common sense” than on mathematical analysis. (Junior Manager A, Junior Manager A, interviews, March 17, 2015) Any implemented strategy should be in compliance with the values of the company, as perceived by these key individuals. Therefore, the decision to offshore or not should reflect the company’s values as well.

I asked the respondents to assess the importance of 12 variables with points from 0 to 5 on Likert scale, 0 meaning no importance, 5 meaning the highest importance. These variables are as follows: manufacturing costs reduction (1); transportation costs reduction into China and East-Asian countries (2); access to the Chinese and East-Asian markets (3); maintaining the current customers (4); protection of intellectual property (5); keeping the level of quality/control over production (6); price of Ekom’s products (7); quality of Ekom’s products (8); financial stability of the company (9); learning (about doing business in China, offshoring process etc.) (10); access to new skills (includes qualified personnel, their skills, talent etc.) (11) and widening production
capacity (12). Besides, I asked the respondents to add other variables they consider important.

3.3 Data Analysis

3.3.1 Country Risk Analysis

There are various strands of literature analysing risks that companies must face when performing international business activities and proposing methods of risks assessment. Risk analysis is an important step in decision-making of every firm about internationalisation, including offshoring. Therefore, I briefly analyse the country risks, which Ekom may face in China. I decided to apply Lassere’s categorisation of risks into political, economic, operational and competitive risks (see Graph 3).

*Graph 3* Country risks

Source: Lasserre 2012

Country risk analysis is a tool that can help managers balance potential risks against benefits and provides insights into the country-level factors that will influence the leveraging of competitive advantages of a firm in a particular foreign country. The aim of my country risk analysis is to examine the chances of various non-market events causing financial, personnel, strategic or other losses after Ekom’s potential decision to conduct offshoring strategy in China. (Rugman, Collinson 2006) As I mention above, I
use Lasserre’s framework for risks analysis. I analyse mainly secondary data provided by international organisations, such as World Bank, as well as journal articles, magazine and newspaper articles. After studying a number of China-related documents and databases about China, I had a pile of information. I categorised them according to Lasserre’s framework into four groups and chose the risks that are the most important and the most relevant for Ekom’s case.

3.3.2 Analysis of the Options

The main research question of the thesis concerns, whether Ekom should offshore some business operations to China or not. Ekom has three options: 1. manufacturing in Slovakia, 2. captive offshoring and 3. offshore outsourcing. In the Chapter 4.3 Ekom’s Options I analyse these three options in the light of the theory of real options, more exactly real options reasoning. In the analysis I draw from literature review and support the findings of literature with relevant information gained from Ekom through observation and interviews. For each of the option I analyse the opportunities and costs using real options reasoning.

3.3.3 Comparison of the options

I compare the options in the light of Ekom’s values making use of the results of the survey. I count the points allocated to the individual values listed in the questionnaire. As mentioned above, the respondents of the questionnaire were two directors of the company and two junior managers. As the perceptions of the directors are the most important and they will be the most influential actors in the decision-making process, I weighed their answers with weight 2.00. Then I sorted the values in descending order. After briefly discussing the results of the questionnaire I analyse the best possible option for Ekom in the light of the values of the company, as perceived by the key individuals. Although plenty of mathematical models are available to assess the options, I do not have required data. Moreover, Ekom is only in the beginning of the decision-making process and as asserted in the interviews with the key individuals, any future steps of the company must be in compliance with Ekom’s values.
3.4 Reliability and Validity

To ensure quality of case study research, four conditions, commonly used in any empirical social research should be met: 1. construct validity, 2. internal validity, 3. external validity and 4. reliability. In the following paragraphs I explore the four conditions.

Construct validity is related to correct operational measures for explored questions. (Yin 2009) I believe that the measures I applied, such as interviews, questionnaires, observation and data analysis are appropriate for the explored questions.

Internal validity refers to establishment of causal relationship. (Yin 2009) As this test or condition is relevant mainly for explanatory studies (Yin 2009) and this case study is more an exploratory study, I do not consider the question of internal validity. External validity concerns what extent can the case study’s results be generalized to. (Yin 2009) In other words, it deals with the question, whether the observed patterns will be valid in other contexts or settings. (Easterby-Smith et al. 2012) External validity of my research is limited, especially due to the fact that I focus only on a single case. Analysing multiple cases would increase the external validity, but it would not allow me to analyse the cases into detail. Moreover, it would be difficult to obtain the in-depth information I have been provided in Ekom from more than one company. Moreover, there are not many Slovak-based companies, which are only considering offshoring to China. However, validity of my research for other firms and other setting is limited. For example, it cannot be generally applied to larger firms or to other offshoring locations. However, my research might be valuable for small and medium-sized enterprises deciding whether to invest in China or not.

Reliability reflects that methods and data sources can be repeated with the same results. (Yin 2009; Easterby-Smith et al. 2012) The main aim of reliability is to limit bias and errors in the research. (Yin 2009; Easterby-Smith et al. 2012) If the research fulfils the condition of reliability, other researchers should achieve the same results when carrying out the same case study all over again applying the same methods as described by the original researcher. (Yin 2009) I can claim that I sufficiently describe methods I use and that the case study can be repeated with achieving similar results. The interviewees are reliable sources of information. Moreover, I have conducted more interviews about the same issues and when carrying out the interviews, I tried to ask
similar questions about the same issues from different points of view to ensure reliability. Likewise, I assume that if the survey through questionnaires was repeated, I would achieve the same results. Besides, I observed the company for five months, which is sufficient period of time to get to know the organisation and understand the vision and values of the company and to make conclusions from my observation.

All in all, my research methods fulfil conditions of reliability and validity with some limitations. I analyse the limitations of my research in greater detail in the section 5.1 Limitations.
4 Analysis

4.1 Ekom Company

*Ekom* spol. s.r.o. is a Slovak company dealing with development and production of medical equipment and with thin sheet metal processing. Company was established in 1992 in Piešťany under humble conditions as a small enterprise of 8 medical technology developers including its six founders. Its first product was an ecological compressor and it has remained to be the company’s core product until today. Nowadays, the company has 202 employees and has sold more than 170,000 compressor units all over the world. In 2013 *Ekom*’s annual sales reached almost 15 mil. EUR.

*Graph 4* Company Structure

Today, Ekom has two divisions – Compressors Division and Metal Sheet Division. (*Graph 4*) Compressors division make up ca. 85% of company’s sales. *Ekom* develops, designs and manufactures low-capacity clean compressed air systems. Product portfolio includes three types of compressors – dental, medical and industrial. (*Graph 5*) Dental compressors are used as a source of clean compressed air at dental clinics and laboratories or as a source of clean air for centralized air distribution systems. Medical compressors are designed to supply lung ventilation equipment or
anesthesia machines with medical grade air. Industrial compressors are used in various industries, such as railway industry, laboratories, food industry, wellness industry and many others.

**Graph 5** Ekom’s sales

![Sales by Compressor Group 2013](image-url)

Lubricating piston rings made of Polytetrafluoroethylene (PTFE), harmless to human health and environment, protective inner coating of air tanks and dryers with filtration ensure high quality of air produced by Ekom’s compressors. The main competitive advantages of the compressors include low noise, heat management, reliability and durability. Moreover, the company considers know-how, after sales services and OEM solutions as their main strengths. Ekom exports 99% of the compressors to 78 countries of the world, most of them to Russia and CIS\(^4\) (45 %) and Europe (43 %). *(Graph 6)* Ekom is planning to penetrate the Asian market, but due to high transportation costs, the sales to Asia and Pacific make up only 6 % today.

Most of the compressors are built in a box made of thin sheet metals. The box fulfills not only aesthetical function, but it reduces vibrations and noise level as well. Ekom had been purchasing the sheet metals from external suppliers, but due to unstable quality, complicated logistics and steadily growing production of compressors, in 2000 the owners of the company decided to establish Metal Sheet Division. Its technological equipment belongs to the world’s top and its production program of Metal Sheet

\(^4\) Commonwealth of Independent States
division covers full range of activities from designing up to final finishing treatment, assembling and service. Housing units for Compressors Division make up almost one third of annual production. The rest is manufactured for external customers.

**Graph 6** Ekom’s exports

![Territorial Structure of Export by Sales 2013](image)

Source: Ekom 2014

Over the years, Ekom has built a good reputation among its customers as a producer of high-quality ecological compressors. However, the sales slightly decreased in 2013 in comparison to the previous year. Although demand in the European and Russian market is still high, the potential demand in Asia, particularly in China is rising rapidly. Furthermore, sales in the Russian market are expected to decrease this year as a result of the ongoing Ukrainian crisis. Thus, Ekom’s aim is to diversify its customer base and penetrate the East-Asian markets, particularly the Chinese market, as there is the highest potential to make profits. Nowadays, they sell only a small number of medical compressors in this market. The main reason is high price of Ekom’s products. In order to make profit, price must include not only the production costs, but also transportation costs from Slovakia to China. In the area of dental compressors there are a number of domestic producers offering compressors of low quality at such low prices that Ekom could not compete. Ekom is already exporting and has better opportunities in the area of medical compressors and industrial
applications, where there are a lot of Chinese customers requiring higher quality and are more willing to pay for it. Thus, Ekom must face competition from the low-cost but also lower-quality Chinese producers in China. But there is a risk that more western producers of compressors will start to manufacture in low cost countries and that the pressure on prices will further increase in the future.

Therefore, Ekom’s founders are seriously considering setting up production site in China. “In the first step, we would start with manufacturing only parts of compressors and assembling components that would be used for assembly of final products in Slovakia. In the second step, we would like to manufacture even final products for the Chinese market and eventually for other Asian countries in China.” (Production director, interview, December 10, 2014). They would like to develop and manufacture products at reasonable price for the Chinese market but without impairing quality of the products. All in all, they seek to decrease production costs, gain access to new markets without impairing the quality of Ekom’s products and production processes. (Ekom 2015)

4.1.1 Offshoring and Ekom’s values

For further analysis, it is important to get to know the values of the Company. In the questionnaire I asked the core Ekom’s employees to rate the importance of twelve values relevant for offshoring. Table 4 shows the results.

What do the results of the questionnaires reveal? (See Table 4) As expected, keeping the level of quality and control over the production and the quality of Ekom’s products ranked as the most important values. However, reduction of manufacturing costs is important as well for the key individuals in decision-making. This is in line with importance of the price of the products, meaning that Ekom seeks to offer the products at reasonable price with reasonable profits. As already stated, Ekom’s value lies heavily in its intellectual property and thus it is natural that protection of intellectual property rights is of high importance. Although, maintaining the current customers has higher priority than access to the Chinese and East-Asian market. This stems from the fact that Ekom has gained a number of reliable and stable customers which build high share of demand for Ekom’s products. Financial stability is important for the company, but ranked in the middle of the ranking of the values. Further, in the second half of the chart ranked learning, access to new skills and transportation cost reduction to China and Eat-
Asian countries. The low score of learning and access to new skills is the result of not realising the potential of China as the source of skilled personnel, new production practices etc. Widening production capacity is of the lowest importance out of the values rated in the questionnaire.

**Table 4** Ekom’s values

<table>
<thead>
<tr>
<th>No.</th>
<th>Value</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>keeping the level of quality/control over production</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>quality of Ekom’s products</td>
<td>30</td>
</tr>
<tr>
<td>3</td>
<td>manufacturing costs reduction</td>
<td>28</td>
</tr>
<tr>
<td>4</td>
<td>price of Ekom’s products</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td>maintaining the current customers</td>
<td>26</td>
</tr>
<tr>
<td>7</td>
<td>protection of intellectual property</td>
<td>26</td>
</tr>
<tr>
<td>8</td>
<td>financial stability of the company</td>
<td>24</td>
</tr>
<tr>
<td>9</td>
<td>learning (about doing business in China, offshoring process etc.)</td>
<td>18</td>
</tr>
<tr>
<td></td>
<td>access to new skills (includes qualified personnel, their skills, talent etc.)</td>
<td>18</td>
</tr>
<tr>
<td>11</td>
<td>transportation costs reduction into China and East-Asian countries</td>
<td>16</td>
</tr>
<tr>
<td>12</td>
<td>widening production capacity</td>
<td>10</td>
</tr>
</tbody>
</table>

The results of the survey are compatible with observations and interviews I made. I refer to these values in the analysis of Ekom’s options in 4.3 and in their comparison in 4.4.

### 4.2 Country Risks Analysis

Taking all types of risk into consideration, China belongs to the group of countries with low risk. (The PRS Group, 2013) According to Country Risk Guide (The PRS Group, 2013) China is the 35th low riskiest country out of 140 countries, just ahead of countries such as Poland, Czech Republic, Poland, United Kingdom and Slovakia (rank 43). In the following lines, I analyse economic, political, competitive and operational risks in China. *Table 5* provides an overview of these risks.
4.2.1 Economic Risks

With GDP of 9.240 trillion USD (current USD) (World Bank 2013), China is the world’s second largest economy. China is the world’s largest exporter and the most populated country in the world. (World Bank 2013) Therefore, it is a country with enormous market with significant consumption growth. (Table 6) Today, China belongs to upper middle-income countries, but according to the World Bank’s estimates (2013) it is likely to become a high-income economy, get ahead the USA and become the world’s largest economy before 2030. Furthermore, Chinese government debt is very low when comparing with the western developed countries, currently slightly exceeding 20% of GDP and according to forecasts it should not exceed 35% before 2050. (IECONOMICS 2014) Official inflation rate was low during the past decades with the current rate about 5%. Moreover China has the largest foreign exchange reserves in the World. (World Bank 2013) Further, quality of education is improving in China and so do the skills and productivity of workers. (Zarrella 2010; World Bank 2013) Thus, in terms of economics risks, China appears like a relatively stable, growing economy.

However, China will probably face a number of risks in the near future. First of all, economic growth is likely to decrease. (Table 6) Any sudden slowdown could uncover inefficiencies in the economy, which are today masked by the high growth rates.
and consequently give rise to fiscal or financial crises and social unrests. (World Bank 2013) Second, real wages, even for unskilled workers, are rising rapidly and China’s comparative advantage in being a low-cost country may diminish. However, the interior provinces remain to be still relatively cheap. Third, although inflation is low right now, due to the rising wages and managed exchange rate policy and other pressures, it might be difficult to control inflation in the future. Fourth until now companies doing business in China have benefited from large and young labour market. Though, due to lower rate of natural increase in during the last decades, China begins to face the challenge of aging population.\(^5\) This will have a number of consequences, ranging from shrinking labour force and lower productivity to social unrests due to weak social system. Fifth, the Chinese economy is dependent on relatively high use of energy and natural resources. Thus the economy is exposed to price shocks of commodities and growing environmental deficit. (World Bank 2013)

**Table 6** China: Projected growth pattern assuming steady reforms and no major shock

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth (percent per year)</td>
<td>9.9</td>
<td>8.6</td>
<td>7.0</td>
<td>5.9</td>
<td>5.0</td>
</tr>
<tr>
<td>Labor growth</td>
<td>0.9</td>
<td>0.3</td>
<td>&quot;.&quot;0.2</td>
<td>&quot;.&quot;0.2</td>
<td>&quot;.&quot;0.4</td>
</tr>
<tr>
<td>Labor productivity growth</td>
<td>8.9</td>
<td>8.3</td>
<td>7.1</td>
<td>6.2</td>
<td>5.5</td>
</tr>
</tbody>
</table>

Structure of economy (end of period, %)

| Investment/GDP ratio            | 49        | 42      | 38      | 36      | 34      |
| Consumption/GDP ratio           | 47        | 56      | 60      | 63      | 66      |

| Industry/GDP ratio              | 46.7      | 43.8    | 41      | 38      | 34.6    |
| Services/GDP ratio              | 43.1      | 47.6    | 51.6    | 56.1    | 61.1    |

| Share of employment in agriculture | 36.7 | 30.0  | 23.7  | 18.2  | 12.5  |
| Share of employment in services   | 34.6 | 42.0  | 47.6  | 52.9  | 59.0  |


### 4.2.2 Political Risks

So far, the national or local government has suppressed any social. However, in the future there is a threat of social unrest and protests. For instance, the Economist

\(^5\) The old age dependency ratio is expected to double in the next 20 years, reaching level between 22 and 23 percent by 2030. That is the current level in Norway or the Netherlands. (World bank 2013)
intelligence unit classified China as a country with high risk of social unrest. (Kekic 2013)

Political risks arise partly from economic problems. Income inequality, inflation, rising cost of housing and uneven access to public services are the main routes of the Chinese people’s dissatisfaction with the economic and political system. Besides, the Chinese government seeks to control migration from poor rural to richer urban areas. Gap of public services availability in rural and urban areas is widening and so is the opportunity gap. (World Bank, 2013; Buckley, 2010) Thus, there is a growing number of people trapped in low-paid jobs in the rural areas and the number of social protests is growing. Question remains, how long can the Chinese government suppress the protests.

Moreover, the social tensions could threaten political stability as well as the economic growth in China. In addition, political risks may be a result of another phenomenon. Evidence from other countries shows that growth of the middle class and improvement of the education result in greater demand for democracy. (World Bank 2013; Kekic 2013)

4.2.3 Competitive Risks

The main competitive risks in China arise from corruption, power of state owned enterprises and importance of wide business networks.

Corruption is high in China. In Corruption Perception Index 2014 China ranked as number 100 out of 175 countries and territories with score 36.6 (Transparency International 2014) Corruption has penetrated every level of state and society to a large extent. The Chinese government have committed to combat corruption in the country, however, it still poses a large risk for doing business in China. (Johnston, 2008; Plipat 2014)

Although China has significantly liberalised its business environment, state enterprises are still powerful and influential actors on the market which, which makes it difficult for private enterprises to enter the market and compete. State enterprises are in close relationships with the Chinese government, they can often gain better access to bank finance, enjoy protection against competition and generally better business

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6 A country’s score indicates the perceived level of public sector corruption on a scale of 0 (highly corrupt) to 100 (very clean). (Transparency International 2014)
opportunities. (World Bank 2013) Besides, there are strategic sectors where the state keeps „absolute control”. Further, the government determined other important industries, such as machinery, automobiles, electronics and information technology, construction, steel, base metals, and chemicals. In these industries, state will seek to retain a “somewhat strong influence.” (Owen, Zheng 2008) Albeit formal barriers of entering these are low, informal barriers may be high. (World Bank 2013)

Social and business networks are more important in China than in the western countries. “In China, deals grow out of relationships.” (Vanhonacker 2004, p. 49) Guanxi, generally translated into English as “personal connections” is one of the crucial factors for business success in China (Buttery, Wong, 1999; Vanhonacker, 2004; Wilson, Brennan 2010) Thus, for foreign companies, there is a risk of falling behind due to having lack of business networks, especially the guanxi networks.

4.2.4 Operational Risks

Operational risks are associated with regulations and infrastructure. First of all, how easy is it to do business in China? In Doing Business 2015 rank China occupied 90th place out of 189 economies. In comparison with 2014 China moved 3 places up. According to Doing Business data and analysis, starting a business in China lasts 31.4 days, entails 11 procedures and costs 0.09 % of income per capita. (World Bank 2014) Overseas firms must face a number of bureaucratic procedures, especially when requiring procedures and permits. (The US-China Business Council 2014; World Bank 2014) Another major concern is enforcement of intellectual property rights. Despite efforts to improve protection of the intellectual property, effectiveness and enforcement of laws is often brought into question. (Chapa, LeMaster 2007) One of the problems is that there is no separation of executive and judicial power. The judicial system is still under control of the Communist party. Enormous corruption and Chinese bureaucracy are also an obstacle in the improvement of intellectual property rights protection and enforcement of law in general. (Zimmerman, Chaudhry 2009) Besides, foreign companies complain about uneven enforcement and implementation of laws and regulations. Chinese authorities often favour the domestic companies. (The US-China Business Council 2014)

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7 These include national defense, electrical power generation and grids, petroleum and petrochemicals, telecommunications, coal, civil aviation and waterway transportation. (Owen, Zheng 2008)
Even though the infrastructure is still lacking behind those of the USA or Europe, it has substantially improved in the last decades and it still remains one of the major priorities of the Chinese government. Chinese government has plans to improve the quality and capacity of roads, railways and other infrastructural facilities which could further contribute to the development of the country. (Chen et al. 2013, KPMG 2013; Roberts 2013) However, the rapid development has negatively reflected in the environment and pollution in all forms has become a severe problem. (Bachman, Burnett 2012) Despite government’s plans to reduce environmental degradation, incentives for environmental protection are still low and the enforcement of environmental standards is weakly monitored. (World Bank 2014)

4.3 Ekom’s Options

As already mentioned, Ekom is considering whether to offshore some business operations to China or not. Thus Ekom has three options to consider: 8 First, Ekom can decide not to offshore and continue at business as usual. Second, Ekom can choose to establish a captive center in China. Third, Ekom can offshore business operations to an external service provider in China. In the following subsections I analyse the costs and opportunities arising from the three options.

Graph 7 Ekom’s option

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8 Besides, it is possible to establish a joint venture with a firm already operating in China, but due to the limited number of pages of this thesis, I do not analyse this option.
4.3.1 Option of manufacturing in Slovakia

The first option means continuing at the business as usual. Ekom would produce at the plant in Slovakia and could export to China. The costs and opportunities are graphically depicted in the .

4.3.1.1 Opportunities

First, Ekom saves financial and human resources needed for offshore operations. Regarding the financial resources, there is no need of large investment into establishing or buying a captive center. Similarly, this option does not lead to various hidden costs. (Kumar et al. 2009; Larsen et al. 2013; Mehta et al. 2006; Ceci, Prencipe 2013.) Instead, the company could use the available financial resources and invest the money otherwise. For example, Ekom could invest in new technical equipment, expand production facilities or invest into research and development. As a result, the quality of production or rate of innovation increases and this brings further benefits, such as increased sales and profits. Also, this option does not require using Ekom’s best managers and other employees for operations at the offshore location. In addition, there is no need of devoting a lot of time to preparation and implementation of the offshoring strategy. Instead, Ekom’s human resources as well as time could be used in a potentially more productive way. This involves investment into innovation, development of already existing facilities or production processes.

Second, control over production processes and management of quality is of high importance for Ekom, as indicated by the interviews and the survey. This option fully supports this value. In particular, quality of products belongs to one of the main competitive advantages of the company. (Production director, interview, March 12, 2015) Besides, Ekom’s managers assume that more Ekom’s competitors offshore their production to low-cost countries in the near future. (Junior Manager A, interview, March 17, 2015; Production director, interview, March 12, 2015) Keeping the control over the quality is more challenging in these countries and firms often do not succeed in coping with this challenge. If this scenario plays out, Ekom’s competitive advantage of manufacturing high-quality products will gain on importance. Similarly, competitors coming from low-cost countries do not achieve the quality of Ekom’s products. (Ekom, 2015) Also, Ekom better protects its intellectual property when performing all business operations in Slovakia. (Lewin 2006) The firm has spent a plenty of time and financial
resources to develop its compressors and other products and production processes. Thus, the company seeks to protect its intellectual property against the competitors. (Interviews, March 2015) Although still lacking behind the countries of Western Europe, protection and enforcement of intellectual property rights in Slovakia is at higher level than in China. (Ekom 2015; The Intellectual Property Rights Index 2014)

Fourth, Ekom currently operates in a well-known environment. Studying Chinese business environment and regulations requires high costs in terms of finance, time and human resources. Even if laws and regulations change in Slovakia, it is still easier to deal with these changes in Slovakia than in China. (Ghemawat 2001) Also, Ekom has established reliable supply chain in Slovakia and neighbouring countries. (Ekom, 2015)

Fifth, Ekom has the opportunity to focus on increasing exports from Slovakia to China. Even though the price is high for the Chinese market right now and it is expected to remain high for at least the following five years, (Commercial director, interview, March 19, 2015) Ekom has the option to concentrate on the top segment able and willing to pay more for the products of high quality. This entails lower risk than offshoring. In case of any difficulties or low sales, it is still easy to stop exporting to China and focus on other markets if they turn out to be more attractive or easier to penetrate than the Chinese market.

Finally, when Ekom decides not to offshore and starts developing offshoring strategy now, it can keep the other two offshoring options open. The firm can wait and decide later on the basis of market development and development of business environment in Slovakia. Eventually, Ekom can wait and follow the moves of its main competitors such as Dürr Technik, Cattani or eVent Medical (Ekom 2015). Then, Ekom can base its decision on their experience and outcomes.

4.3.1.2 Costs

First, if Ekom decides not to offshore, they will continue at manufacturing at relatively high costs. (Ekom 2015) Albeit it is possible to rationalise and optimize production processes, in order to keep the high quality, there is not much space to reduce the costs. (Junior Manager A, interview, March 17, 2015) Wages are rising in Slovakia and so do the material costs, energy costs as well as taxes and other duties. Besides, the current Slovak government tends to make business environment even less
business friendly and doing business has become more difficult in recent years. (Ekom 2015; CFO 2014, Transparency International 2014) Therefore, it will be difficult to keep pace with bigger competitors benefiting from economies of scale and competitors manufacturing in countries with lower costs or more favourable business environment. (Ekom 2015)

Second, although Ekom can penetrate the Chinese market even without manufacturing there, penetration without being physically present in China is more difficult. The transportation costs are very high and further increase the costs of already relatively expensive products for the Chinese market to high levels. (Commercial director, interview, March 19, 2015; Production director, March 12, 2015) Another concern is that it is difficult to increase sales in the Chinese market without having functioning business network in China as proposed by Buttery, Wong, 1999; Vanhonacker, 2004 and Wilson, Brennan 2010. Without being physically present in China, building such a network is difficult and costly.

Third, finding skilled employees has become a problem for both the manual works and the engineering works. (Junior Manager A, interview, March 17, 2015; Production director, interview, March 12, 2015) Moreover, the management of the company has not changed since the establishment and Ekom’s key employees are employed since the very first years of the company’s existence. Finding new, skilled personnel appears to be one of the main challenges in the near future. (Ekom, Interviews, March 2015) In particular, it is a problem to find skilled workers for technical tasks. This relates with the situation of Slovak education system, where a significant shift may be observed. Young people tend to study humanities rather than technical programs and as a consequence, there is a lack of skilled, well-educated technical staff in the Slovak labour market. (SITA 2011; Žitňanský 2012)

Fourth, even though the capacity of production facilities in Slovakia is sufficient today, Ekom’s production capacity is limited. Its utilisation varies from year to year, depending on the amount of orders. (Junior Manager B, interview, March 17, 2015) For example, in 2010 and 2011, there was low demand for Ekom’s products due to economic crisis and Ekom faced problem of unutilised capacities. In contrast, in 2012 the amount of orders increased significantly and the company dealt with lacking production capacities. (Ekom 2014; 2015) This implies that if Ekom follows its plans to
grow, the current production capacity will be insufficient and Ekom will have difficulties with orders processing.

Finally, although Ekom still has the opportunity to keep the other options open when deciding not to offshore right now, waiting can make future offshoring to China more difficult and disadvantageous. Today, loans are offered at low interest rates (Ekom 2015) making it favourable to invest in a captive center in China. Besides, if Ekom’s competitors start to implement offshoring earlier than Ekom, they may reap all the first-mover advantages (Meyer, Peng 2011), such as choosing an attractive location, buying an available plant, contracting the supplies or building business-networks.
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**Graph 8 Costs and opportunities of manufacturing in Slovakia**

Note: the width of arrows expresses the probability of the costs and opportunities to play out; low ––, medium, ––, high

**Costs**
- high manufacturing costs
- high price of products
- unfavourable conditions for doing business

**Opportunities**
- no need of large offshore investment
- no hidden costs of offshoring
- keep/increase quality of products, processes

**Manufacturing in Slovakia**
- low sales, profits
- low demand in China, East Asian markets
- high manufacturing costs
- uncertain Slovak business environment
- difficult to penetrate into China
- decrease of demand in Europe, USA
- competition from low-cost producers
- late-mover disadvantages
- uncertain conditions for offshoring

**Outcomes**
- increasing sales, profits
- profits from licences
- increase sales, profits
- keep other options open
- offshore
- focus on other markets, offshore locations
- keep constant market share
- maintain existing customers
- keep constant R&D investments
- keep constant profit margin
- keep constant cost of production
- keep constant environmental impact
- keep constant quality of products, processes

**Factors**
- uncertain conditions for offshoring
- high manufacturing costs
- high price of products
- unfavourable conditions for doing business
- decreasing demand in Europe, USA
- competition from low-cost producers
- late-mover disadvantages
- uncertain conditions for offshoring
4.3.2 Option of captive offshoring

Second option I consider is captive offshoring. Ekom can set up a captive center in China. Ekom could build a new plant from scratch or buy an already existing plant, which would be wholly owned by Ekom. The costs and opportunities are graphically depicted in the Graph 9.

4.3.2.1 Opportunities

The most important opportunity arising for Ekom from this option is cost reduction. (In accordance with Nachum, Zaheer 2005; Pisani 2007; Roza et al. 2011 and Lewin et al. 2009) Due to much lower wages in China compared to Slovakia, Ekom could manufacture components and whole machines cheaper. (Interviews, March 2015)

As a consequence, Ekom could decrease the price of its products. There is high probability that with the lowered price Ekom’s products become competitive even in China and other developing countries. Out of Ekom’s three main competitors – Dürr Technik, eVent Medical and Cattani, only Dürr Technik had manufacturing facilities in China. Though, the company has started backshoring business operations from China recently. (Production director, interview, March 12, 2015) Thus, two of Ekom’s main competitors are manufacturing in high-wage countries, and the other one will join them in the near future. Thereafter, decreased manufacturing costs could turn out to be one of Ekom’s competitive advantage for a certain period of time even in the markets of developed countries. Besides, as already mentioned, currently low interests rates in Slovakia favour investment in a captive center in China. (Ekom 2015; NBS 2014)

Second, manufacturing in China rapidly decreases transportation costs to this market as well as to other potentially large East-Asian markets such as India, Indonesia or Japan. (Ekom 2014) If Ekom starts to manufacture whole machines in a Chinese plant, the price could be significantly lower in comparison with the price of exported products. Besides, manufacturing in China enables higher flexibility in delivering products to the Chinese and other East-Asian customers. All this contributes to the expectation of higher sales and profits in China and East-Asian countries.

Third, being physically present in China facilitates penetration into the Chinese market not only due to the decreased prices. Having a captive center in China makes it easier to get to better know the market, Chinese customers and Chinese business environment. Consequently, Ekom could tailor its products to the Chinese needs and
increase sales in the market. As already stated, business networks are important for success in China. (Buttery, Wong, 1999; Vanhonacker, 2004; Wilson, Brennan 2010) Having permanent staff in China increases the probability of Ekom’s success in building these networks.

Fourth, albeit low wages are the main driver of the Chinese market attractiveness, education and skills of the Chinese workers are improving. Thus, Ekom would gain access to the qualified skilled personnel for both the engineering positions and the manual works. As “it is a problem to find qualified personnel for reasonable salary in Slovakia,” (Junior Manager B, interview, March 17, 2015) this opportunity is important from the long-term perspective.

Fifth, running a captive center in China provides opportunity to learn how to manage a company in other country than Slovakia. The firm could potentially later apply the experience from managing the offshoring process and offshore center in other offshore locations. Captive center enables to maintain control over protection of the intellectual property and the quality management when comparing with offshore outsourcing. That is of high importance for Ekom as survey about company values indicates. This depends on management of the Chinese subsidiary and especially on management of human resources in China. Higher level of intellectual property rights protection could be achieved if Ekom relocates some experienced personnel from Slovakia to China or hires new reliable personnel able to supervise over following the manufacturing standards and protecting the intellectual property.

Finally, Ekom still has the option to sell the subsidiary if this option does not fulfil the expectation or if Ekom’s strategy and market conditions change.

4.3.2.2 Costs

The main costs associated with establishing an offshore center are large investment. Both buying an already existing company and providing it with new facilities or building a new plant require high investment. Financing of the captive center establishment depends on the price of required investment. Ekom has its own available financial resources, though, if the price exceeds a certain limit, (Production director, interview, March 12, 2015) Ekom will need to take a loan (Interviews, March 2015) and pay off the debt. This could restrict the resources available for development of new products and continual improvement of quality. Apart from the initial
investment, Ekom needs to count with further costs of running the plant. Ekom will need to coordinate the operation of the subsidiary in China with the Slovak headquarter as well as ensure sufficient communication between them. As a consequence, coordination and communication cost arise together with other hidden costs, which are difficult to estimate, but may be very high. (Kumar et al. 2009; Larsen et al. 2013; Mehta et al. 2006; Ceci, Prencipe 2013)

The second biggest challenge is the fact that Ekom’s management has experience with neither offshoring nor operating business in China. (Interviews, March 2015) Therefore, there will be need of hiring experienced personnel to help with the coordination of the operations in Slovakia as well as with operation of the offshore plant. This could be difficult as there are not many firms with offshoring experience in Slovakia. (Drobný 2004; CFO 2013) In addition, a question arises: “who will manage and work in the Chinese captive center?” (Production director, interview, March 12, 2015) Relocating some of the Slovak staff would ensure continuity and quality of the production. However, majority of the key personnel is not willing to relocate to China. (Interviews, March 2015) Besides, this requires additional costs of paying the Slovak employees for the relocation. Hiring Chinese managers and workers appears to be easier, but this leads to the third large challenge, and that is ensuring quality of the products, production processes, supply of high quality materials and various other technical, labour and environmental standards. Ekom’s managers expect that impairment of the quality of Ekom’s products or even only of components will have serious consequences. (Interviews, March 2015) It could hurt Ekom’s name, result in decreased sales in the segments requiring high quality and loss of customers. This is closely linked with protection of intellectual property rights that is the key for further success of the company. (Ekom 2015) Although the probability of successful protection of intellectual property rights in the captive center is higher than in case of offshore outsourcing, there is still risk of leakage of information about Ekom’s products and production processes. As proposed by China IPR Helpdesk (2014), information can leak through various channels. In captive offshoring, the most dangerous is leakage through employees. Employees may work for certain period at Ekom’s subsidiary and then they may simply quit the job and disclose the gained information to other firms or use the information on their own. It is also common that valuable information also leaks
through suppliers, distributors as well as customers. (China IPR Helpdesk 2014) Then, enforcement of intellectual property rights in China is a long, costly process with unpredictable results. (China IPR Helpdesk 2014)

Fifth, risks arise from various dimensions of distance. (Ghemawat 2001) Cultural distance, administrative distance, geographic distance as well as economic distance between China and Slovakia is high. Operating in China and managing Chinese staff poses large cultural barriers in terms of values, language, communication etc. Chinese business environment differs from the Slovak and European environment, where Ekom’s managers have substantial experience. (Interviews, March 2015) Setting up a plant in China is complicated by plenty of Chinese regulations, bureaucracy and corruption as analysed in the Country Risks Analysis. Finally, as already mentioned, business networks and relationships are important in China. (Buttery, A.E.; Wong, Y.H. 1999) Without having experience and contacts in the Chinese market, building the networks appears to be a difficult task. Ekom could solve this problem by hiring people with experience and social networks in this field, but this strategy entails the already mentioned risks such as cultural barriers and leakage of information about the intellectual property.

Lastly, there is a high uncertainty associated with this option. Production costs in China are lower than in Slovakia right now, but they may rise in the near future, as prognosed by the World Bank. (2013) Besides, demand in Europe, Russia as well in China is uncertain (Ekom 2015) and low demand may lead to overcapacity of production facilities located in China. Consequently, keeping the unused facilities may be costly.
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Graph 9 Costs and opportunities of captive offshoring

Note: the width of arrows expresses the probability of the costs and opportunities to play out; low, medium, high

Costs

- large initial investment
- hidden costs (of coordination, communication)
- no experience of Ekom with offshoring
- need of personnel for the offshore center
- high distance between Slovakia and China
- no networks in China
- decreased control over quality management
- leakage of intellectual property
- decreased of sales, profits
- loss of customers
- damage of Ekom’s trademark

Opportunities

- manufacturing costs reduction
- decrease of transportation costs to China, East Asia
- access to the Chinese, East-Asian markets
- flexibility for the Chinese, East-Asian market
- penetration to the Chinese market through physical presence
- access to qualified personnel
- learning
- option to sell the subsidiary
- increase sales in China, East Asia
- increase of sales, profits
- increase efficiency, innovation
- establish other subsidiaries abroad
- profit

Captive offshoring
4.3.3 Option of offshore outsourcing

The third option, which Ekom has, is offshoring some business operations to an external supplier in China, i.e. offshore outsourcing. Some of the opportunities and costs arising from this option are similar to those of the captive offshoring. The costs and opportunities are graphically depicted in the Graph 10.

4.3.3.1 Opportunities

The first and the most attracting opportunity for Ekom is costs reduction (in compliance with Nachum, Zaheer 2005; Pisani 2007; Roza et al. 2011; Lewin et al. 2009). If Ekom decides for offshore outsourcing, manufacturing costs may be reduced even more than in the previous option for a number of reasons. To begin with, Ekom can expect that an external supplier in China will most likely employ cheap Chinese labour force, what decreases the costs. Moreover, there is no need of building or buying a plant, markedly decreasing the required investment and risks arising from it. The major eventual investment needed in this option is the investment into technological equipment to ensure the quality of the manufactured products. It is clear that these investments are much lower than in case of a captive center. Thereafter, Ekom could offer its products at lower prices making them more competitive in the low-cost countries. Moreover, in longer-term perspective, assembly of the complete products could be outsourced to the supplier. (Production Director, March 12) This step depends on the capability of the external supplier to assure high quality of the production processes and products, following internationally and by Ekom required standards and suppliers reliability. This is consistent with directors’ vision of offshoring simple manufacturing tasks first, followed by offshoring more complex tasks later. (Production Director, March 12, 2015; Commercial Director, March 19, 2015) Completion of the products in China leads to reduction of transportation costs to China and East-Asian countries and enables better flexibility when supplying these markets.

Second, as there is a plenty of potential external suppliers in China, it will not be a problem for Ekom to find a supplier with an already running company and experience. Outsourcing to such a service provider means that there is no need of studying operational environment into detail, managing and implementing all the administrative and bureaucratic steps necessary to operate a company in China. As a consequence, this
saves Ekom a lot of time and financial resources. Benefits of offshoring could be expected to come in much shorter time when compared with the previous option. Besides, assuming that the supplier has a well-functioning and equipped site, a large advantage is that the supplier most likely has experience in running a business and has established business networks in China.

Third, albeit control and supervision over the supplier’s plant is limited, offshore outsourcing offers learning opportunity for Ekom. Slovak firm could learn how to run a business in China as well as learn new manufacturing practices. These could be applied at the headquarters in Slovakia. Also, after getting confidence and contacts for operating an owned plant, Ekom could establish a wholly owned subsidiary.

Fourth, outsourcing production brings higher flexibility. It is easier to increase or decrease the amount of components manufactured by the supplier depending on demand for Ekom’s products. This is particularly important, as demand for Ekom’s products is not constant and influenced by many factors. (Junior Manager B, interview, March 17, 2015; Ekom 2014) Further, if any problems in cooperation with an external supplier appear or it turns out that the strategy is not effective, it is always relatively easy to stop carrying out of the offshored operations by the supplier. Moreover, the competition among the external suppliers is big in China (Zarrella, 2010) and Ekom could always find a new supplier.

4.3.3.2 Costs

Some costs associated with offshore outsourcing are identical or similar with costs of captive offshoring. The biggest risk of this option is impaired ability to control production processes and quality of products as well as leakage of the intellectual property, what stands in sharp contrast to Ekom’s priorities. As already stressed, the quality of the products and keeping the standards for production processes is a high priority for Ekom. (Ekom 2015) In the offshore outsourcing mode, the supervision is difficult. Production standards in China are lacking behind those of Europe. (DeLarentis, 2009; Economist 2009) As described in the subsection 4.3.2.2 on costs of captive offshoring, impairing the quality of Ekom’s products could damage Ekom’s reputation as a high-quality manufacturer and have further consequences. (Ekom 2015) Likewise, the costs concerning intellectual property rights are similar to those of captive offshoring. In addition, in the offshore outsourcing mode, there is a risk that all the
disclosed information to the external supplier could be misused and taken to his advantage. The option to mitigate both the lack of quality and the leakage of intellectual property is to outsource only simple, standardised tasks.

Second, although expected investment are much lower than in the above analysed option, if Ekom seeks to ensure high quality and standards of production, investment into technological equipment or facilities might be necessary. These depend on the equipment and facilities of the supplier, but required investment might be higher than expected. Third, there is a need to coordinate the outsourced activities with the operation in Slovakia, and communicate with the supplier. Thereby, communication and coordination costs arise as in the previously analysed option. Besides, Ekom’s managers have no experience with offshore outsourcing. (Interviews, March 2015) It is highly probable that this will lead to inefficiencies when managing the processes connected with the outsourcing strategy. Fourth, Ekom must pay for the products manufactured by the Chinese supplier. In addition to this, Ekom must count with transportation costs in case of manufacturing only components in China and assembly of the whole products in Slovakia.

And finally, there are costs connected with distance. (Ghemawat 2001; Jensen et al. 2013; Kshetri 2007; Dibbern et al. 2008) Relevance of its dimensions is similar to captive offshoring, analysed in the subsection 4.3.2.2.
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**Graph 10 Costs and opportunities of the offshore outsourcing**

Note: the width of arrows expresses the probability of the costs and opportunities to play out; low → medium → high.
4.4 Comparison of the Options

As I already stated in Methodology, in this early stage of decision-making about offshoring, it is difficult to assess the opportunities and costs arising from the three analysed options. As started as a micro-enterprise and due to its relations among the partners it resembles a family business, vision and values are important for every decision that the company makes. Thus, the comparison of the options is based on the values concerning offshoring revealed by the questionnaires described in the first section of this chapter. On the basis of the analysis in the section 4.3, Table 8 shows how the individual options impact the values, whether in positive or negative way, or whether the impact is questionable.

Table 7 Comparison of the Options

<table>
<thead>
<tr>
<th>No.</th>
<th>Value</th>
<th>manufacturing in Slovakia</th>
<th>captive offshoring</th>
<th>offshore outsourcing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>keeping the level of quality/control over production</td>
<td>+</td>
<td>?</td>
<td>-</td>
</tr>
<tr>
<td>2</td>
<td>quality of Ekom´s products</td>
<td>+</td>
<td>?</td>
<td>-</td>
</tr>
<tr>
<td>3</td>
<td>manufacturing costs reduction</td>
<td>-</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>4</td>
<td>price of Ekom´s products</td>
<td>-</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>5</td>
<td>maintaining the current customers</td>
<td>+</td>
<td>?</td>
<td>-</td>
</tr>
<tr>
<td>6</td>
<td>protection of intellectual property</td>
<td>+</td>
<td>?</td>
<td>-</td>
</tr>
<tr>
<td>7</td>
<td>access to the Chinese and East-Asian markets</td>
<td>-</td>
<td>+</td>
<td>?</td>
</tr>
<tr>
<td>8</td>
<td>financial stability of the company</td>
<td>+</td>
<td>-</td>
<td>+</td>
</tr>
<tr>
<td>9</td>
<td>transportation costs reduction into China and East-Asian countries</td>
<td>-</td>
<td>+</td>
<td>?</td>
</tr>
<tr>
<td>10</td>
<td>learning (about doing business in China, offshoring process etc.)</td>
<td>-</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>11</td>
<td>access to new skills (includes qualified personnel, their skills, talent etc.)</td>
<td>-</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>12</td>
<td>widening production capacity</td>
<td>-</td>
<td>+</td>
<td>+</td>
</tr>
</tbody>
</table>

Note: “+” the option has positive impact on the value, “-” the option has negative impact on the value, “?” the option may have both positive and negative impact on the value

The option of continuing at all business operations in Slovakia appears to be the most appropriate in order to keep the high level of quality, maintain control of Ekom’s
products and protect intellectual property. As a consequence, it is the best strategy to maintain the current customers. Also, no high investments are required and similarly there is no need of additional funding and thus threatening financial stability of the company. However, the manufacturing costs as well as the transportation costs remain high. Thus, price of Ekom’s products will remain uncompetitive for the Chinese markets and penetration through exports will be also complicated by the lack of business networks and the lack of knowledge about the Chinese business environment.

Both modes of offshoring will have positive impact on reduction of manufacturing costs and thereby on the drop in Ekom’s prices. Captive offshoring enables to keep better level of quality and control over production processes as well as quality of Ekom’s products. However, this depends on a number of factors, such as selection of employees, type of offshored processes etc. There are similar concerns about protection of intellectual property. Maintaining the current customers and Ekom’s reputation in Europe and America will then depend on the extent of keeping the level of quality and control, but establishing a wholly owned subsidiary offers better opportunity to succeed. This mode also offers even better opportunities of penetrating into the Chinese market and other East-Asian countries and even higher decrease of transportation costs. Also, Ekom will gain access to new skills. Offshore outsourcing is more suitable for gaining experience in running business in China or the process of offshoring, as Ekom could learn from the external service provider already operating a business in China. Decrease of manufacturing costs could be higher than in the case of captive offshoring, as outsourcing requires much lower initial investment and costs for relocation of employees etc.

In short, comparing captive offshoring and offshore outsourcing on the basis of the values rated by the key individuals of the company, captive offshoring turns out to be more in compliance with Ekom’s values. Even when maintenance of the current level of product’s quality, quality of production processes, protection of intellectual property rights and keeping the current customers are questionable and more uncertain than in case of producing in Slovakia, these values are much easier to achieve than when deciding for offshore outsourcing. Also, it ensures better access to the East-Asian markets and reduction of transportation costs. Albeit offshore outsourcing is less costly and may be implemented faster, it does not seem to be a long-term solution for Ekom.
Perhaps, it could be used as a temporary stage to build networks in China, learn about the Chinese business environment and to decrease manufacturing costs of some parts temporarily, but from long-term perspective, captive offshoring is more in accordance with the values of the Company.

Comparing the option of not to offshore with captive offshoring, producing in Slovakia is advantageous for keeping the level of quality, maintaining control over production processes, protection of intellectual property and as a consequence, maintaining the current customers. However, this can be achieved even if Ekom decides for establishing a captive center in China, if managed carefully. Then the only remaining disadvantage is the need of large investment into setting up a captive center. However, Ekom has relatively large financial reserves. (Production Director, March 12, 2015; Commercial Director, March 19, 2015) Besides, actual financial situation and offers from the Slovak banks enable taking a loan at low interest rates at the moment. (Ekom 2015)

All in all, which option suits Ekom’s values the best? First of all, it is important to note that the final decision should be based also on more precise financial analysis. However, to analyse the options in detail, Ekom must make a decision, which operations should be offshored, pick a location in China, research Chinese factories, which could be eventually for sale or serve as potential service providers, explore and analyse other related issues. Then, it is possible to make financial estimates of the costs and benefits of realizing the individual options. Similarly, real options valuation may be carried out. This is an initial analysis and should serve as the first, fundamental step in the decision making about whether to offshore or not.

Continuation at manufacturing in Slovakia turns out to be the safest option and the best option to keep the level of quality, control over the production processes, maintaining the current customers and protecting the intellectual property. However, if company decides to take the risk, captive offshoring could offer Ekom a number of opportunities, out of which cost reduction and access to the Chinese market are the most valuable. On the other hand, Ekom must count with country risks analysed in 4.2 and deal with the relatively high risk of a decrease in the overall quality of the production in China as well as the intellectual property leakage. As already stated in the text above, this can be avoided by ensuring sufficient supervision over the production, employing
reliable managers or relocating some of the employees from Slovakia for a certain period of time. Also, Ekom could offshore only simple, routinized tasks in the beginning and start with manufacturing if they gain some experience in dealing with these issues. Although offshore outsourcing does not correspond with the most important values of the company and is more problematic in contrast with captive offshoring, which ensures quality and control to larger extent, this mode could be used as an intermediate stage. Ekom could start with offshore outsourcing, gain experience from the Chinese business environment, make use of the external supplier networks and later set up a captive center. In conclusion, in this phase, it is not easy to recommend a single option, as there are too many factors determining the optimal solution. All of the options offer various cost and opportunities and the final decision should be based on a detailed analysis focused on the specific components or final products carefully selected for offshoring by the company management.
5 Discussion

The section provides a summary and discussion of the performed analysis. Then I contrast my findings with the international business theories presented in the literature review.

In the presented single case study I analysed Slovak-based SME Ekom. In the introduction I formulate the main research question: Should Ekom start offshoring production to China? Besides the main question, I asked two subquestions. First, if Ekom decides to offshore, which offshoring mode, i.e. captive offshoring or offshore outsourcing, is more suitable? Second, what do the international business theories suggest and what does the performed analysis of the costs and opportunities suggest? I set the objective to answer the research question on the basis of the studied literature, practical information from the company and various secondary sources. My research should serve the Company for an initial stage of the decision making process.

To begin with, what does my analysis suggest? I analyse three possible options that Ekom has. First, Ekom can decide to continue at producing and keeping all business operations in Slovakia. Second, they can choose to establish a captive center in China and offshore some of the manufacturing activities there. Third, Ekom can outsource some of its manufacturing operations to an external supplier.

I analyse the risks arising from doing business in China, which are relevant for two offshoring modes, but especially for the option of captive offshoring. Based on Lasserre’s (2012) framework, a number of economic, political, operational and competitive risks arise. Concerning economic risks, there is a risk of economic slow-down, growth of real wages, inflation, aging of population, price shocks of commodities and environmental deficit. Political risks in the form of social unrests may arise mainly from unsolved economic problems and demands for democracy. Operational risks include large bureaucracy, weak enforcement of law, weak protection of intellectual property and lacking infrastructure. Competitive risks involve corruption, preferred position of state-owned enterprises and large business networks. These risks are also relevant also for other firms considering either offshoring or foreign direct investment in China. Although these risks are considerable, China as a manufacturing location and market offers several advantages for Ekom. Above all, the Chinese labour is still significantly cheaper than in Slovakia and supply of qualified labour force is growing.
steadily. Moreover, China represents a huge potential market with growing middle class and purchasing power of individuals, state organisations and companies operating in China. Thus, it is obvious that China as a location possess important location-specific advantages for Ekom. However, if Ekom proceeds with further stage of decision-making process and chooses a specific location in China, further analysis of risks shall be carried out, as there are large regional differences in China. Also, China is a rapidly developing country. Hence, if Ekom postpones the decision-making, new risk assessment will be necessary as the current conditions are likely to change even over a short period of time.

In the subchapter 4.3 I analyse three options – manufacturing in Slovakia, captive offshoring and offshore outsourcing. All of them offer various opportunities and costs including real options. They lay in market access, need of investment, hidden costs, manufacturing costs, maintenance of control over production processes, product’s quality, access to skilful personnel and others. Though, the company is only in the very initial stage of the decision-making process and therefore, no data such as potential height of the investment in a captive center, considered external suppliers or required demand in China are available. Thereafter, it is difficult to completely assess the analysed options. From the little available information, which could help in the assessment, I use the vision and values of the company. Results of a questionnaire, filled in by the key individuals in the further decision making, reveals Ekom’s values. As expected on the basis of my observations, keeping the level of quality, control over production processes, reduction of manufacturing costs, price of Ekom’s products, maintaining the current customers and protection of intellectual property were rated as the most important. Taking all risks, costs and opportunities into consideration, continuation at manufacturing in Slovakia is the least risky option. However, if the Slovak company decides to run the risks of establishing a wholly owned subsidiary, captive offshoring could offer a lot of opportunities such as cost reduction and access to the Chinese market.

The values or priorities are important, as Ekom was built in very modest conditions and they do not want to change the philosophy of the company. Thus, if Ekom postpones the decision making about offshoring, they should later analyse the potential options again in the light of the company values. For example, if the rapidly
growing Chinese and East-Asian market suddenly become more important because of the long-term view of low demand in Russia, the order of the analysed options may change in favour of captive offshoring. Though, Ekom should count with difficulties in maintaining desirable control over the production processes, the quality of products and take measures to protect intellectual property rights. Ensuring this will be a challenge, but it can be achieved when taking appropriate steps. Despite all of the opportunities which offshore outsourcing could bring, it does not encourage preservation of Ekom’s most important values. This offshore mode could be used only as a temporary stage in order to reduce manufacturing costs or gain experience from the Chinese business environment and later consider setting up a captive center. Eventually, Ekom could outsource only simple and standardised tasks to minimize costs associated with this option with the main aim of manufacturing cost reduction. Altogether it is difficult to suggest the single best option out of the three analysed. From the findings, however, it seems that relocating the production of some non-crucial components to an external supplier in China could be an acceptable first step in exploring the Chinese production options both in terms of the company priorities and values as well as the potential risks.

What does the literature suggest and how does it contrast with my suggestions? The transaction costs economics proposes that Ekom could offshore to reduce manufacturing costs. (Teece 1986; Forsgren 2008) Concerning the selection between captive offshoring and offshore outsourcing, the theory proposes that it should be based on asset specificity and uncertainty. (Jensen, Pedersen 2012; Mohiuddin, Su 2008; Jensen et al. 2013) As Ekom considers only offshoring production of simple parts and simple manufacturing abilities of workers in the first phase, asset specificity is low and therefore offshore outsourcing appears to be the best option for Ekom. However, when they decide to increase production for the Chinese customers and manufacture greater part of the products in China, asset specificity as well as the uncertainty grows, and thus captive offshoring becomes more suitable. This is more or less in compliance with my reasoning, as I recommend offshore outsourcing only as a temporary stage.

In terms of resource-based view Ekom should offshore to acquire new capabilities or resources and leverage its scarce firm-specific resources. (Doh 2005; Mohiuddin, Su 2008; Mudambi, Tallman 2010) These could be qualified technical staff and skilled workers as it becomes a problem to find and attract highly skilled workers
for non-administrative positions financial and working conditions in Slovakia. (Ekom 2015) I analysed this opportunity in the analysis of the costs and opportunities resulting from the three options, but my survey suggests that the key individuals of the company do not realise the learning opportunities and potential of the Chinese labour market. They perceived it more as a source of cheap labour. According to Prahalad, Hamel (1990) and Quinn, Hilmer (1994) Ekom should focus on core competencies and strategically outsource other activities. Hence Ekom should concentrate on activities such as research and development, after-sales services and OEM solutions and outsource other activities, such as manufacturing or assembly of simple parts. However, even though assembly of complete machines does not belong to the core competencies, the company does not want to lose control over this activity because of the fear of loss of the main customers who high quality of the products. Hence, this supports my conclusions only partially.

Uppsala model suggests international involvement in incremental steps. (Johanson, Vahlne 2009) Ekom has long-time experience with exports to various countries all over the world, which favours offshoring. Uppsala model proposes offshoring to countries, where the firm has some prior experience. In addition, it puts stress on psychic distance and recommends moving at first to countries with lower psychic distance and later to those with higher. (Johanson, Wiedersheim-Paul 1975) As the exports to China not significant and psychic distance between China and Slovakia is relatively large, according to this model, offshore outsourcing appears to be better option as it means lower level of involvement. Although this theory is widely criticised, in principle it is in line with my findings. Ekom could start with offshore outsourcing and after gaining sufficient experience, it could proceed to establishment of a wholly-owned subsidiary.

In subchapter 4.3, where I analyse costs and opportunities of manufacturing in Slovakia, captive offshoring and offshore outsourcing, I partially draw from the theory of real options. Application of real options reasoning enables to look behind the immediate costs and benefits of the three options. Though, if the analysed firm was in a more intermediate stage of decision-making and more exact data were available, it would be possible to evaluate the options by means of real options valuation, what would bring more concrete findings.
To sum it up, propositions of transaction cost economics, resource-based view as well as Uppsala model basically supports my findings. Similarly to my recommendations, they do not provide unequivocal answer to the main research question. I suggest that besides taking propositions of these theories into consideration, firms should set or decide, what are their priorities and their values. Then they can start with further analysis of their options. This is valid especially for smaller or family run firms, such as Ekom, where the key managers perceive their firm as something more than a revenue-creating tool. For instance, Ekom’s managers seek to remain to be perceived as a manufacturer of high quality products. Thus, even if offshoring to China could bring large cost benefits along with higher profits, if the managers are not sure that the quality of Ekom’s products is maintained, they will not decide for offshoring.

Finally, many scholars emphasise constraints that SMEs face in the process of internationalisation. (Buckley 1989; 2008; Johnson, Turner 2010; Musso, Francioni 2012; Ferreira 2013; Huett et al. 2014) Out of the constraints they state, Ekom is limited especially in financial and human resources. Even though the company can afford investment into offshore center, Ekom’s financial resources are limited and the managers will decide for this offshoring mode only if there is high probability of success. Concerning human resources constraints, Ekom does not have managers with appropriate international experience, neither experience with offshoring. Hence, constraints significantly enter into decision making about offshoring as they increase costs and risks.

All in all, findings of this single-case study are to high extent in compliance with findings of the relevant literature. However, when analysing SMEs which confront with the decision about offshoring, it is important get to know the firms properly. This should include in-depth knowledge of firm’s and key managers’s values.

5.1 Limitations

My research has a number of limitations. First, as already repeated more time in the thesis, the research should serve only for an initial stage of decision-making process of the analysed company. Thus, I have only a limited amount of exact data. For example, the research could be more exact, if the company was considering two concrete alternatives, for instance buying one of a couple of available sites in China or
outsourcing to some concrete Chinese suppliers. Second, more issues could be explored. For example, I could explore to a larger extent the institutional environment in China, possibilities of financing the investment or investigate firms of similar size offshoring to China. However, I have limited time to complete the thesis and the number of pages of the Master’s thesis is limited as well. Third, the generalizability of single case studies is always limited. It would be interesting and generalizability would be higher, if more firms were included in the research and compared with each other. However, firms usually do not provide public information when they only start considering offshoring. Therefore, it would require substantial effort to recognize relevant companies. Fifth, I analysed three options – manufacturing in Slovakia, captive offshoring and offshore outsourcing. Another appropriate option could be a joint venture with a Chinese partner. I do not include this mode because literature usually compares only captive offshoring and offshore outsourcing and as already stated, the number of pages is limited. Sixth, I consider only China as a potential offshore location. I conduct a short country risk analysis, but do not compare it with other locations, even though other locations such as India or other East-Asian countries might be attractive as well. The reason for taking into account only one country is that the location was determined by the Company. Seventh, the research could be enriched by more surveys carried out in the Company. For example, I could investigate what other employees besides the key individual think about offshoring or whether they would be willing to be relocated for some time to China. I could not conduct research with similar questions like these as the offshoring option is not yet open for a general discussion within the company.

5.2 Further research

There is lack of academic works about offshoring and of SMEs. Therefore, further research would contribute to a better understanding of this phenomenon. Besides, it could facilitate decisions of SMEs about whether to offshore or not. Recommendations for further research could be derived from the limitations. Similar study could be conducted in a firm in later stage of decision-making applying a real options valuation model. Scholars could analyse other potential countries besides China. Further, the case could be analysed into greater detail in terms of finance or human resources and other issues. Also, multiple-case study could bring more general results
applicable for more firms. If allowed and after a proper explanation of the survey and all the circumstances, a survey among employees of a company could be made regarding their attitude to offshoring, relocation and their expectation about compensation for relocation or foreign experience of managers.

What is more, more research among firms, which already offshore business operation abroad would be beneficial. For instance, research similar to Offshoring Research Network’s (ORN) survey regarding firms’ risks and motives of offshoring could be carried out only among SMEs. Scholars could explore the question concerning how the SMEs with captive centers got finance, how they deal with intellectual property right protection and assurance of products and production processes’ quality. All in all there is a wide range of interesting and unexplored topics in the area of offshoring by SMEs.
6 Conclusion

In this single-case study I analysed Ekom, a Slovak SME developing and manufacturing medical technology. The aim of the Master’s thesis was to answer the research question: Should Ekom start offshoring production to China? To answer the raised question I use data collected through interviews, a questionnaire and my own observations as well as secondary data.

The analysis starts with country risk assessment. Based on Lasserre’s (2012) framework I highlight important economic, political, operational and competitive risks, which Ekom shall consider before deciding to offshore to China. Thereafter, partially using real options reasoning, I analyse costs and opportunities arising from three options that Ekom has, namely: 1. continuation at manufacturing in Slovakia, 2. captive offshoring and 3. offshore outsourcing. Consequently, I compare these options. As Ekom stands at the very beginning of the decision-making about offshoring, only little real exact data are available. Besides, qualitative analysis was preferred by the management of the company. Therefore, I make the comparison of the options in the light of Ekom’s values concerning offshoring. The most important values concern keeping the level of quality and control over production, quality of Ekom’s products, manufacturing costs reduction, price of Ekom’s products, maintaining the current customers and protection of intellectual property. Hence, after taking the values and preceding analysis of the costs and opportunities into consideration, manufacturing only in Slovakia appears to be the least risky option. However, if Ekom’s managers decide to take a risk of offshoring to China, captive offshoring is more in compliance with Ekom’s values and offers opportunities leading to further growth and higher competitiveness, especially in the Chinese and East-Asian markets. Offshore outsourcing is the option least complying with Ekom’s values. Though, it is the most suitable option for shorter term or for offshoring of only simple, standardised tasks. The performed analysis implies that starting with offshore outsourcing of non-crucial components to China could be an acceptable first step for Ekom. This seems to be the best option both in terms of the company priorities and values as well as the potential costs.

Thus, there is no clear answer to my research question. However, as the management of the company has no experience and only general knowledge of
offshoring, the thesis should serve for the future decision-making. Furthermore, even if Ekom abandons the option of offshoring to China now, the thesis could be used as a framework for any considerations about offshoring or eventually about foreign direct investment even to other locations in the future. What is more, managers of other companies considering offshoring may also use the basic ideas and insights presented.

In conclusion, the thesis points out that also SMEs consider and adopt strategy of offshoring. Besides, SMEs may be an interesting subject for analysis and it may be easier to get valuable-research related information from the key individuals in SMEs than in large corporations. In addition, this work shows that there is not a single theory that could be applied to answer a question concerning whether to offshore or not. To get the whole picture of the problem, researchers or managers should draw on several international business theories, including transaction costs economics, resource-based view and real options reasoning in particular.
7 Bibliography


A case study of a Slovak SME potential offshoring to China

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A case study of a Slovak SME potential offshoring to China

Master’s Thesis

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A case study of a Slovak SME potential offshoring to China

Master’s Thesis

biznisom.html?utm_source=profit&utm_medium=dennik&utm_campaign=listi
ng
Annexes

Annex I

- What is vision of the company? What are the main aims?
- How do you see the future of Ekom? Where do you see the main risks, opportunities?
- What is the main competitive advantage of Ekom?
- What are Ekom’s main customers?
- How Ekom’s customers perceive Ekom?
- What are the target markets?
- What are the main strategic markets for the future?
- How does situation in the medical sector look like?
- What are the main Ekom’s competitors?
- Where is the highest/lowest demand?
- What are the main problems Ekom must deal with?
- What are the main risks for the future of the Company?
- Why are you considering offshoring to China?
- Which business operations would be offshored?
- Do you prefer captive offshoring or offshore outsourcing?
- Does Ekom have any experience in the Chinese market?
- Why are sales in China low?
- Where do you see the main risks associated with offshoring?
- Where do you see the main opportunities associated with offshoring?
- What are they advantages and disadvantages when compared with Ekom?
- Do Ekom’s competitors offshore? Do they planning to offshore?
- How would Ekom’s employees perceive offshoring?
- Are they willing to relocate to China?
- Do any of Ekom’s employees have experience with offshoring?
- What are the main disadvantages of manufacturing only in Slovakia?
- What do you think about Slovak business environment?
Annex II

**Questionnaire**

Please fill in the questionnaire. The first column includes values important for the decision about offshoring (i.e. whether to offshore production of some components, eventually of whole products into China or not.). Please, indicate with points from 0 to 5 on the Likert scale in the column “importance”, how important the values are for Ekom. 0 means no importance, 5 means the highest importance. Eventually, state other values.

<table>
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<th>Values</th>
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<td>keeping the level of quality/control over production</td>
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<td>quality of Ekom’s products</td>
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<td>manufacturing costs reduction</td>
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<td>price of Ekom’s products</td>
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<td>transportation costs reduction into China and East-Asian countries</td>
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<td>protection of intellectual property</td>
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<td>financial stability of the company</td>
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<td>access to the Chinese and East-Asian markets</td>
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<td>access to new skills (includes qualified personnel, their skills, talent etc.)</td>
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<td>learning (about doing business in China, offshoring process etc.)</td>
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<td>maintaining the current customers</td>
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<td>widening production capacity</td>
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