

The Chinese bittersweet cake in Orbea´s internationalization

Berrbizne Urzelai (*) and Francisco Puig (**)

Abstract: Orbea is the oldest and biggest bicycle manufacturer in Spain and one of the most recognized bike brands in the world. With more than 175 years in the market, in the year 2007 Orbea decided to set up its third manufacturing plant in the Industrial park of Kunshan. After 8 years with activity there, in 2015 the company decided to close down the factory and reallocated its resources closer to the Headquarters. Some of the reasons that influenced its entry and exit decisions had their origin in the specific context of investment (place): China and the country-of-origin (COO) cluster in Kunshan. Other reasons of the reshoring and backshoring were related with the evolution of the sector, public support services (space) and market positioning in Asia- Pacific. However, as a result of that process, the company has acquired some knowledge and experience that will shape the strategy of Orbea. The objective of this case study is to analyse the role of the place and the space in the international relocation strategy of Orbea. This will involve studying the main decision factors as well as the major organizational adjustments related to the linkage between the structure and the location. The chapter compares the main literature on entry reasons, location mode and offshoring with the interviews conducted to Orbea's managers during the period 2013-2016. This work will guide business practitioners in their international manufacturing strategy and academics to contribute to the study of the advantages generated in specific contexts such as COO clusters.

Keywords: Offshoring, Reshoring, Cluster, Bicycle, Orbea, China.

* Berrbizne Urzelai
PhD. Student Univ. of Valencia
E-mail: urzelaib@gmail.com (corresponding author)
Telephone: +34652711705

**Francisco Puig
Department of Management, Univ. of Valencia
E-mail: francisco.puig@uv.es

The Chinese bittersweet cake in 1

Orbea’s internationalization..... 1

- 1. Introduction.....4
- 2. Literature Review5
 - 2.1 Going international: motivations, location and mode.....5
 - 2.2 Offshoring and reshoring.....7
- 3. The bicycle sector 10
 - 3.1 Definition of the sector..... 10
 - 3.2 The firm Orbea and its internationalization..... 13
- 4. Methodology and data 14
- 5. Analysis and discussion 15
 - 5.1 Going to China 15
 - 5.2 The offshoring strategy 17
 - 5.3 The bittersweet experience 19
- 6. Conclusions.....23
- References.....25

DRAFT

1. Introduction

Over the last 15 years, companies in more developed countries, especially those in traditional manufacturing industries (textiles, toys, bicycles, etc.), have made important changes in their relationship with foreign supply and sales markets (Buckley and Ghauri, 2004). This evolution has become visible in the spatial reorganization of productive activity, by transferring certain activities of the value chain (offshoring) to low-cost countries, as is the case of Spanish firms in China. The process has been especially intense in the last decade, especially in manufacturing industrial clusters (Belussi, 2015). As a result of this process, the mortality rates of local companies have increased, thousands of jobs have been lost and there has been a decrease in competitiveness due to the transfer of specialized knowledge and the externalization of productive competencies (Puig and Marques, 2010).

As a result of diverse factors of globalization (WTO -World Trade Organization- agreements, new technologies or the reduction of transport costs), we are currently undergoing a period of intense changes, which at all levels, are questioning these measures and that reflect a new wave of localization, relocation and reverse delocation patterns (reshoring and backshoring) of companies and their activities (Lahiri, 2015). The European backshoring rate topped the offshoring one in 2013 (Bals et al., 2015) and Spain, along with Italy, Ireland, or Germany is one of the main backshoring destinations (Za, 2014). However, despite its socio-economic importance and increasing trend, most empirical studies on the internationalization of firms and offshoring have neglected this new approach (Gray et al, 2013).

This case study analyses the whole process that the main Spanish bicycle manufacturer (Orbea) took from establishing a manufacturing plant in China, until it decided to close down that subsidiary and reinforce its activities in Europe. For that, the case is based on international business literature and follows the logic described by the eclectic paradigm of Dunning (OLI) (Dunning, 1988). Specifically,

after the bittersweet result of its offshoring process into China, the case discusses two main aspects of managerial interest about the spatial reorganization of the productive activity: (a) was it a good strategy to go to China? and (b) ¿what can we learn from this experience?. All these elements have been analyzed taking into account the singularities of the bicycle industry. The case is organized as follows. Section 2 provides a literature review. Section 3 presents the sector and the firm object of the research. Section 4 analyses and discusses the findings. In the last section, implications and conclusions are discussed.

2. Literature Review

2.1 Going international: motivations, location and mode

In general, companies might find internal or external triggers to go international. When internationalizing into distant (BRIC) markets, Ulrich et al. (2014) found that, control, flexibility and risk were evaluated less important internal factors than personnel and financial resources, while for external factors, the most important was market potential whereas the trade barriers, cultural distance as well as the political and economical risk are viewed as main obstacles. Other aspects such as managerial training, support policies or entrepreneurial culture of the company can also act as facilitators of that decision.

Internalisation theory (Buckley and Casson, 2016) and Dunning's (1988) eclectic paradigm of ownership, internalisation and location advantages (OLI paradigm) are some of the most accepted theories that explain why firms decide to establish units abroad. Those 3 elements of the OLI paradigm are considered simultaneously conditions and drivers. In line with Kedia and Mukherjee (2009) the theory suggests a framework to explain through the ownership advantages (O) why firms choose physical investments (greenfields or acquisitions) rather than other modes such as licensing, importing, etc. Location (L) advantages could be

used to understand the existence of raw materials, lower costs, etc. of those locations, which explain the nature and destination of investments, especially for efficiency-seeking firms in developing countries. (I) Internalization refers to the advantages of own production rather than producing through a partnership. Particularly, internalisation and location advantages are the main arguments for offshoring production to low-wage countries (Kinkel and Maloca, 2009).

Dunning (1988) proposed four types of foreign direct investment (FDI) motivations: (1) resource-seeking, 2) market-seeking, 3) efficiency-seeking, and 4) strategic-asset seeking FDI. Catwell and Mudambi (2005) state that firms locate in a host country with a motivation to either exploit or explore their resources. In the case of firms investing in developing countries like China we can find two main motivations: a) market-seeking and b) efficiency-seeking (Puig et al, 2016).

Although the relationships among the FDI motivations and the location choice are well established in the literature (Kim and Aguilera, 2015), many companies do not act so rationally and decide to invest in learning processes or imitation. Especially under situations of uncertainty, such as entering foreign markets, actors tend to prefer relationships with homogenous others and often imitate compatriot firms when selecting foreign market locations (Pangarkar and Yuan, 2009). In these cases, location decisions are very often determined by the knowledge of foreign market opportunities, which is commonly acquired via existing interpersonal links rather than systematic market research. It is usual for networking, in the form of social and business interactions, to take place in agglomerations and clusters. Studies on agglomeration have examined the location patterns chosen by firms when entering foreign markets, especially when it comes to distant markets. According to Tan and Meyer (2011), two of the most visible types of co-location are the industry clusters (interconnected firms specialised in a particular field) and the country- of-origin (COO) clusters (interconnected firms by ethnic ties). The existence of networks that are locally embedded in a place could be seen as a source of competitive advantage. Moreover, institutions, especially in transition-

ing economies such as China, can play a critical role when it comes to create the appropriate place that includes infrastructure, resources, knowledge, and skills needed by firms. Government policies often use industrial clusters as a development strategy that provides those factors, attract investment and improve the performance of the firms.

When a company internationalizes another important decision to adopt is the entry mode, since this selection will influence the future performance of the company (Dikova and Brouthers, 2016). Although several options will probably be available, the entry mode decision will have to be made considering several external and internal factors. In line with Morschett et al. (2010) as external factors we can find the socio-cultural distance, the country risk/ demand uncertainty or the market size and growth, while as internal, the firm's size, international experience, or product are determining. The capital to be invested, the sector of activity or expected profitability could also influence this decision. The adequacy of the different entry modes associated to the level of ownership (WOFE vs. JV) and the establishment mode (greenfield vs. acquisitions) will depend mainly on the degree of control and the commitment that the firm wants to adopt.

2.2 Offshoring and reshoring

The economic downturn that began in 2007 has highlighted the international reorganization and relocation of the business activities. The terms "delocalization" and "multilocation" has continuously been mentioned in the media, business and political debates, often referring to companies that seek efficiency and markets and thus close down their operations and relocating their activities to emerging countries. However, it is not the same to delocalize or re-localize a firm or an activity. According to authors such as Contractor et al (2010) or Puig and Marques (2010) in the case of manufacturing firms four modes of productive strategies can be considered: (1) classical delocation, where plants are closed domestically and reopened abroad; (2) the externalization of activities, as a contract between domes-

tic/ foreign firms (outsourcing); (3) the transfer of activities among subsidiaries of the same firm located in different countries (offshoring); and (4) the multilocation, when firms carry out several strategies of re-organization and re-location simultaneously.

In the last decade, two kind of response have been predominant (Carballo-Cruz, 2012), proactive and defensive. The first one is a response followed to increase profit margins and competitive capacity, to accumulate knowledge and manage complex production networks in international markets (market-seeking). The defensive response is driven by the increase of labour costs, reduction of margins and the increase of competition in the local market (efficiency-seeking).

Over the last few decades, many scholars have examined the complex phenomenon of outsourcing and offshoring, at country, industry, firm and managerial levels. While outsourcing is defined as a "what" strategy that hands over an organizational activity to a (domestic or international) supplier, the offshoring is a locational strategy related with the place and with "where" to transfer specific parts of their business processes (Ellram et al, 2013). Manufacturing offshoring is becoming an increasingly interesting option for firms to enter new markets (Coucke & Sleuwaegen, 2008). Jensen and Pedersen (2011) analysed the economic geography of offshoring and found that while manufacturing is relocated into low-cost destinations, research and development goes into high-cost destinations. Puig et al (2016) analysed a sample of 31 Spanish firms and found that manufacturing firms with efficiency-seeking entry reasons were associated with clustered locations to a higher level than trading-service firms (market-seekers).

At a global scale, advanced activities are mainly attracted to North America, while Asia attracts as many advanced activities as Western Europe. However, as evidenced in manufacturing, the nature of the activity is an important determinant of the location choice of the firm (Jensen and Pedersen, 2011). As Tate et al. (2014) mention, although companies have started to move towards inland China looking for lower labour costs, the higher transport cost and pipeline inventory of

these regions are offsetting the labour cost benefits. As wages are increasing sharply in China, countries such as Vietnam or even Mexico are attracting the attention of foreign investors and have provoked a new wave of relocation.

Offshoring strategies also create many challenges for the firms when decisions are based on costs, or due to the distance (geographic and institutional) between the host and home locations, or unexpected changes (Larsen et al, 2013). Firms start to see the disadvantages of offshoring when those locations lengthen their delivery times, suffer quality issues, increase wage rates and labour shortages or home countries strengthen their position and productivity by employing new technologies (Bals et al., 2015). As a result of these changes firms are forced to re-concentrate parts of their production from own foreign locations or foreign suppliers. When this process takes place and implies going back to the domestic site in the home country, it is called backshoring (Kinkel and Maloca, 2009) or reshoring (Ellram, 2013). Irrespective of the terminological choice, all the definitions acknowledge this phenomenon as a location decision that involves production activities, and modifies an earlier implemented off-shoring decision by re-establishing certain productions in the country of origin (Fratocchi et al., 2016).

Kinkel and Maloca (2009) analysed offshoring and backshoring activities of 1663 German manufacturing companies and showed that every fourth to sixth production offshoring activities were followed by a backshoring within the following 4 years, mainly due to lack of flexibility and quality problems at the foreign location. Kinkel (2012) found that particularly export-intensive companies tended recently towards (re-)concentrating of their production capacities, trying to exploit the benefits of higher capacity utilisation and a superior relation to variable costs to fix costs at their existing locations. The decisions to disengage can arise through imperfect information, unpredictability of events that manifest in not reaching expectations or in problems with the offshore location (Bals et al, 2015). Quite often, firms that backshore as managerial or operational adaptation are following differentiation strategies that are not compatible with the offshore location (Martinez-

Mora and Merino, 2014). Recently Fratocchi et al, (2016) proposed a theory-based classification of 31 motivations for reshoring according to the goal (customer perceived value vs. cost efficiency) and the level of analysis (internal or external environment). They call for a reconsideration of the “smile” approach to internationalization, in particular, the need for co-location of R&D and manufacturing or the need for proximity with customers to manage customization and increase the quality of interaction. Also, although remarkably distant, it is worth emphasising the increase of competitiveness of the country-of-origin (Spain), due to available skilled labour to a lower cost and the increase of labour costs in the host country (China or other Asian economies). Moreover, the empirical studies (Puig et al, 2016) also recognizes other determinants as the logistic costs, financial needs or cultural differences and, specially, the difficulty of having a proper product and/or to access Chinese markets.

3. The bicycle sector

The changes in the space namely globalization are a source of challenges that firms need to face, along with the specific threats of the place and the sector. The understanding of these challenges is useful to better understand the environment in which firms operate and how they can be more efficient in the implementation of their strategies. Besides, each sector is formed by several sub sectors that differ from each other in terms of the characteristics of the products and the situation of the markets, as well as their added value. In this sense, it is recommended that the study of the offshoring strategy is analysed by considering the sector-specific characteristics of the bicycle in a given context like Spain.

3.1 Definition of the sector

The bicycle sector can be considered global, although it has its peculiarities in each country. All over the world bicycles are used for different purposes (travel,

leisure, etc.) and everything indicates that its use is becoming popular. While in countries like India the bike is a basic means of transportation (although not yet accessible to everyone), in the USA or Spain the bike is associated to the practice of sport. This aspect leads us to emphasize that the current characteristics of customers, markets and products are very heterogeneous between countries and regions, and that there is an important atomization of market and players.

According to the main sectorial association in Spain (AMBE, 2016), the bicycle sector would be that which covers all business areas related to the manufacturing, distribution and marketing of cycling products, not just at a competition level, but also for leisure segments or as a means of mobility. This definition allows us to associate it with other sectors, known as "traditional manufacturers". In addition, it provides a distinction of three broad areas of analysis: complete bicycles, components (spare parts) and accessories (textiles, footwear, helmets, electronics and others), being the first one, manufacturing of bicycles, the most relevant (AMBE, 2016).

It is important to note that the manufacturing of bicycles comprises 7 main subsectors with unequal characteristics and revenues: mountain, road, triathlon, urban, leisure, kids and electric. In those countries where the bike is used mainly as a means of transport, the consumption of locally produced "urban" bikes is dominant (for example, Hero Cycles Limited in India). In places where the use is associated to the practice of sport, the road or mountain bikes that are produced globally are more popular (for example, Giant in the USA).

In fact, if we look at the number of units sold, the main subsector of this industry is the mountain bikes (48%), followed by the kids (36%) and urban (9%) ranges, being the percentage of road and e-bikes quite low (5% and 2%). However, if we focus on the revenues of the sector, we observe several differences. Mountain sector concentrates 63% of the revenues and road bikes 17%, being the other three ranges, almost equally divided, and accounting for the rest 20% of the revenues. The reasons of that asymmetry rely on the sales unit price that in Spain, in aver-

age, is around 1400 euros.

Similar to other sectors as textile, toys or footwear we could say that the customer knows and values the product and its cost, and is aware about the attributes of what he/she is purchasing (such as its functionality, fashion trends, specifications, others). As AMBE (2016) points out, in this sector, the importance given to the intangible aspects of the product (such as branding and design) is increasing. It is significant that, in the ranges of mountain and road bicycles, two different business models coexist. On the one hand, the one that chooses to compete on costs and that, in many cases, adopts the brand of vertically integrated companies (Decathlon, El Corte Ingles and Sprinter). On the other hand, the market segment of high value-added bicycles in which there are hundreds of brands, many of them domestic (Gazelle in Holland or Raleigh in the UK) but many other international (Trek, Specialized, Cannondale, Giant, Felt, Look, Fuji, Colnago, BMC, Cervelo, Scott, Canyon, Pinarello, Bianchi and Orbea) (Ochoa and Arana, 2007).

Another important feature of this industry is the international scope of the production and marketing activities. Firms can easily multilocate the different activities of their value chain. This aspect is the key and a trigger for the implementation of offshoring strategies (Contractor et al, 2010). In general, Asia is the geographical area in the world where the largest number of bicycles are produced. In general, China stands out as the leading global manufacturer (about 60%) followed by Japan (especially for components). In Europe almost 40% of production is concentrated in Germany (18%) and Italy (23%), the main markets are USA and the EU, highlighting the Netherlands, especially in the segment of urban bicycles (CONEBI, 2016).

On the other hand, despite the fact that this sector supports high tariffs in order to avoid anti-dumping, if we take into account the data offered by CONEBI (2016), the commercial flows of bicycles between China and EU28 in the period 2005-2015 were on average, around 40 billion euros for imports from China, but barely 5 billion for exports to China (8/1 ratio). Although it is remarkable that

while imports appears to be stable (with ups and downs) the exports has an increasing tendency. Regarding the commercial flows between China and Spain, the indicators are similar, on average, imported bicycles accounted 1 billion euros and exports were about 100 million euros, highlighting a significant growth from 2011 onwards, where the value of exports accounted 300 million in the following years (ratio 10/3).

3.2 The firm Orbea and its internationalization

The Orbea Cia. was founded in 1840 in Eibar (Gipuzkoa, Spain) in a region (Basque Country) with an important tradition in the metal sector. In its beginnings the company's activity as the manufacturing of firearms and ammunition. In 1926, after World War I, the family that owns the company (the Orbea-Murua family) decides to diversify the activity and focus on the bicycle sector (Orbea and Cia. is created). Their more than 85 years of knowledge in the metal-mechanical sector and the expertise they had in twisting tubes and welds encouraged them to take an important step in the two-wheeler market. Orbea's growth was impressive and in just ten years it became a leading company at a national level. In 1969 it suffered a crisis due to family problems. In order to avoid its disappearance Orbea was transformed into a cooperative society (Orbea S. Coop.) and incorporated into Mondragon business group. In 1975 it was located in the same place (Mallabia) where nowadays its headquarters is (that accounts for about 200 employees). Although with some ups and downs, during the next 20 years the company continued to grow unstoppably. Those ups and downs came from the crisis of the 1970s, a reconfiguration of the sector that experienced a greater demand for mountain and road bikes, and the emergence of new international competitors. The commercial success that Orbea had due to the sponsorship of the cycling teams that were several times winners of the most important cycling competitions in the world (Miguel Induráin effect) was impressive (Ochoa and Arana, 2007)

As a result, in 1998 Orbea began its internationalization process. During

its expansion process, motivated mainly by external factors, it tried to look for new markets to sell its prestigious bicycles. This activity began in France but it acquired much more importance in the USA. With a strategy focused on the mid-high range it continued to expand and now Orbea is present on over 50 markets in all five continents. Besides its exporting activity, in 2005 the company also adopted offshoring and multilocation strategies in Portugal and USA. While in the plant in Spain the firm's activity included the design and manufacturing of almost all the products of its range, the other subsidiary in Portugal manufactured kids and mountain bikes and in USA and Australia the company established two assembly plants.

In 2007 Orbea decided to set up a plant in an Industrial park in Kunshan (a country-of-origin cluster in China). La new factory called "Orbea Kunshan" had a total of 23.333 sqm (5.3000 built sqm) of modern facilities, around 50 employees and manufactured mountain and road bikes. These facilities were similar to those which Orbea already had in Spain and Portugal (around 230 employees there). After 8 years with a bittersweet performance in Kunshan, in 2015 the company decided to re-shore the factory and reallocated its resources to Portugal and Spain. From this process a couple of interesting questions arise: (a) was it a good strategy to go to China? and, (b) which strategic aspects did Orbea learn from that international experience?

4. Methodology and data

In line with Yin (2009), to answer the questions before asked we have chosen a case study approach and Orbea Kunshan as the case setting. The key principle underlying the selection of our case is their representativeness because the findings could be transferable to other firms involved in the spatial reorganization of their productive activity

The data used come from different sources such as company reports in

AMADEUS database, the compilation of press releases, informal conversations² and two formal semi-structured interviews: 1) to the General Manager of the subsidiary on 25th of March 2013, 2) to the General Manager of the company on 15th of April 2013,.

All of this information was completed with a visit of the authors to the headquarters on 14th of January 2016, and a more far-reaching research done in Mondragon Kunshan Business Park (Urzelai and Puig, 2016a, 2016b). The contrast of these sources allows a triangulation of the information and give a greater validity to the research (Yin, 2009).

5. Analysis and discussion

5.1 Going to China

In quite a relatively short time, China has emerged global having joined the WTO, strengthened ties with ASEAN, hosting the 2008 Olympics and becoming according to some, not only the regional leader in East Asia but the future world superpower. It is impressive that while other developing nations generally experience periods of boom and bust, China has enjoyed a steady growth-rate above 9% since the 1980s and in the last 20 years 250 million people in China have been lifted from poverty (Fernandez and Underwood, 2006). China has a lot of attractiveness in both sides: production and market. It has the large and low-cost labour force, a relatively good infrastructure for exports and the ability to purchase inputs at world prices. Moreover, the China's internal market is enormous and it is rapidly growing (Branstetter and Lardy, 2006). These aspects and the fact that China has a favourable regime for foreign investors made this country and important location.

² The authors took part in several spontaneous conversations during lunch and coffee breaks at the park itself and in out-of-work events organized by the Basque House in Shanghai. These conversations provided a more detailed understanding of staff members' opinions and feelings

³ The authors are very grateful to Zigor Aldama (journalist of Vocento Group) for his collaboration.

Orbea, as other firms, did not ignore China's attractiveness. Furthermore, the company had to consider other external factor linked to the legal environment, i.e., the antidumping law and taxes that in 2007 the sector had, could be eliminated.

"There was a lack of knowledge and uncertainty about the antidumping taxes that the bicycle had. The tax is of 48.5% but at that time and after China entered the WTO, some indicators were telling us that there could be a liberalization" *General Manager of Orbea (Aldama, personal communication, 15th April 2015).*

"Orbea comes to China as a measure of facing a forecasted situation. China is putting a lot of pressure so that custom tariffs that are applied to bicycles produced in China are eliminated. When this occurs, as it happened in other sectors, all firms will come and we will be ready to compete with the Chinese firms" *General Manager of Orbea (Aldama, 2007, translated).*

The company acted proactively to adopt a position before the sector got liberalized. The plant was built seeking efficiency but market too, especially for Europe:

"The plant was thought to produce 40-60 thousand units for Europe" *General Manager of Orbea (Aldama, personal communication, 15th April 2015).*

However, the liberalization did not happened and thus, Orbea had to rethink its strategy in China and move towards the Asian market. Besides, the company had realized that the image associated to the bicycle in China (as a mean of transport) was also changing and that it could become not only a way of transport but an element for entertainment and social positioning.

"We saw quite clearly in 2007 just before the Olympic games. People started following-up bicycle-related sports activities. The Tour took place in Beijing, there were requests to the cycling teams to come to Europe, etc., a huge change [...]. In 2010 we started the commercial activity for the domestic market" *General Manager of Orbea (Aldama, personal communication, 15th April 2015).*

"Market research we have conducted indicates that the trend for cycling in China will grow very sharply in the next five years. However, we also noticed that brand presence, even though it is better known than we thought, is still somewhat low, so good brand positioning, combined with marketing efforts will be vital to our success in China" *General Manager of Orbea Kunshan China (Orbea, 2011).*

"The international firm wants its Kunshan factory in China to be the epicentre of the expansion process that Orbea is undertaking in the Region, both in terms of production and distribution" *Global Marketing Manager of Orbea (Orbea, 2011).*

5.2 The offshoring strategy

In the internationalization development part of Kunshan plant was also had a logistic value and served to source the subsidiaries in the US and in Australia. This plant acted supporting a kind of multilocation strategy. According to Orbea (2011) the setting up of the Orbea factory in China, in addition to responding to logistical reasons (most Orbea suppliers can be found in Asia) was due to a global positioning strategy. The country-of-origin cluster also acted as an attractive location factor and centripetal force.

“This plant reaches markets that are closer to China than to Spain. In fact, the markets served by this plant are Asia, Australia, the US, and South America. This plant also has logistic value, as most bike manufacturers buy 70 to 80% bike parts in Asia: frames, group sets, saddles, seat posts... It's a decision based on logistics and profitability. Being in China, you save 40 days in shipping and cut down costs. We assemble the bicycles in Kunshan and then send them to these markets. This makes us more competitive” *General Manager of Orbea Kunshan China (Orbea, 2008)*.

“We were mainly concerned about being near the customers and establish a market position, reduction of costs was not the main reason” *General Manager of Orbea Kunshan China (Urzelai, personal communication, 25th March 2013)*.

The market expansion was taken through different actions. One example was the sponsoring of events such as the Mongolia Bike Race, an epic mountain bike race in which 120 bikers from all around the world compete for 10 days and 1,200 km through the arid lands of Mongolia.

“This event is part of our establishment in Asia and we hope to turn it into an event of character and international significance [...] In fact we are sending some of our Orbea riders out to the race and there will be other world class riders” *Global Marketing Manager of Orbea (Orbea, 2011)*.

What was originally a centre to produce and export bicycles was gradually been transformed into the real Orbea headquarters in Asia (Orbea, 2011).

“The Chinese plant is a milestone in the Mallabia-headquartered company's history, intended to meet market demands as efficiently as possible” *General Manager Orbea Kunshan China (Orbea, 2008)*.

"It's a special moment for Orbea, before we only exported and now we are only selecting distributors to help us to project our brand to Chinese consumers. At the end of this year and Orbea bicycles will be available in stores" General Manager Orbea Kunshan China (Orbea, 2011).

Orbea was already operating in Asia and Australia before setting up their manu-

facturing plant in Kunshan. So how had the plant changed their approach and how was the process to reach their market goals?

“Orbea had already built a brand and an image for itself in the region, but now, with the plant in China, we’re stronger. We can provide better services, supplying a wider range of products. Now Orbea Australia can offer better customer services. The same applies to Orbea USA. We’re where demand is. Before this plant was set up, we used to sell our products on order. Now we’re going to produce larger lots, with a four- to five-month estimate of orders to be placed” *General Manager of Orbea Kunshan China (Orbea, 2008)*.

The pricing strategy in China focused on a category of around 1500-2000 dollars as the market has big player such as Gigant or Merida.

“We have the capacity to compete above 1500, not only manufacturing in China but in Spain and Portugal, but below that it is very difficult, and the main players have more than 80% of the distribution” *General Manager of Orbea (Aldama, personal communication, 15th April 2015)*.

The way to access the market was to find sponsorship and distribution leaders that could drive the Orbea brand in China.

“Orbea will simply apply the same criteria in China as it has given fantastic results in the rest of the world: find those dealers that are as close as possible to the users at all levels, so that the triangle Orbea - shops - users work with absolute fluency” *General Manager of Orbea Kunshan China (Orbea, 2011)*.

Multilocation strategy has been often mentioned by Orbea as their approach to internationalization. The company clearly distinguishes this strategy from delocalization strategy.

“Multilocation has to do with production diversification based on profitability. Orbea’s plant in China isn’t the result of delocalisation or relocation, as we don’t transfer production lines from Mallabia to Asia. The ultimate goal is to reach users by meeting their demands. We need to open markets in different places to serve customers where demand is and thus be really competitive. Orbea is always seeking the best opportunities to meet market needs” *General Manager of Orbea Kunshan China (Orbea, 2008)*.

As mentioned before clusters are no longer the outcome of FDI, but the precondition for attracting FDI to China (De Propris & Driffield, 2006; Puig et al, 2016). The manufacturing plant was established in the country-of-origin business park that was promoted by Mondragon Business Group. In fact, Orbea was one of the four founding members of Anaitasuna, the General Service company that was set up in the park to help the members with their establishment process and to deal with government institutions.

“Other companies joining the same place was an influential location factor as being together as part of a group is important and a big support [...] it helps to develop guanxi, as the bigger you are the better guanxi you can get [...]. Proximity matters as you can talk everyday about your problems. I know people that had been sent to remote places in China and they have not been more than one year there” *General Manager of Orbea Kunshan China (Urzelai, personal communication, 25th March 2013).*

“There is vision that this place is attractive to be, and in a country where guanxi matters, to have a relationship (with the local authorities) facilitates things. Besides, to have so many firms from different sectors operating in the same geographical area gives an added value on knowledge about HR, finance, negotiation with banks, etc. We act as a cluster and negotiate as a group (industrial park)” *General Manager of the park's general service company (Urzelai, personal communication, 25th March 2013).*

The General Manager of the plant, involved in the setting up of the firms, explained this establishment process:

“Orbea settled in China with three other companies in the Mondragón group, namely, Oiarso, Wingroup, and Orkli. Our plant is located in Kunshan, just 40 kilometres away from the country's economic hub, Shanghai. It took us one year to get the factory started [...]. By May 2007, we had built the plant, set up the machinery, and hired the people. Orbea Mallabia (HQ) sent specialists for different sectors (quality control, assembly lines, and production, for instance), so that they could help us get the plant started. At the beginning we manufactured five mountain bike models, something simple to start with, let's say” *General Manager of Orbea Kunshan China (Orbea, 2008).*

Economic development and growth in China has been strongly linked to the FDI and the agglomeration of industrial activity in certain regions of the country, especially in the Eastern provinces. Although historically Chinese institutions and local governments had been active in attracting foreign investment by giving firms tax incentives to attract anchor companies, the policy is moving towards supporting inner provinces (“Go West” policy) and firms in the Eastern regions had noticed that.

“A few years ago, there were benefits for foreign investors, but little by little, the quota limit was reached. China's held the leadership in foreign investment for ten years. Now that the quota limit has been reached, corporate taxes are being levied. In the past, foreign companies didn't have to pay corporate taxes for the first three to five years, but now it's no longer so” *General Manager of Orbea Kunshan China (Orbea, 2008).*

5.3 The bittersweet experience

According to the OLI paradigm there is a set of (net) competitive advantages

stemming from the country-of-origin and the position of the FDI that influences the investment motivation, namely, efficiency seekers versus market seekers. As mentioned previously, Orbea redefined its strategy towards a mix efficiency-seeking and market-seeking approach in China and they thought it was a matter of time to reach success.

“With these raw materials and the strength that the Orbea project has already demonstrated in other parts of the world it is only a matter of time before planet Asia surrenders to the benefits Orbea models offer and the style of leisure that identifies the brand” *Global Marketing Manager of Orbea (Orbea, 2011)*.

However, the domestic market did not reach the maturity point that the company expected, and this was one of the main reasons for Orbea to take disinvestment measures in Kunshan.

“Nowadays we are in a very tight situation, even if we are from the beginning in this park, this year for example we did not earn money. This means we need to tight our belts and we have very strict targets this year” *General Manager of Orbea Kunshan China (Urzelai, personal communication, 25th March 2013)*.

“The domestic market did grow that much and although our selling capacity has had significant growth (selling more than 1.5 million euros), the sells did not fulfil all the expectations” *General Manager of Orbea (Aldama, personal communication, 15th April 2015)*.

"The problem is that the factory is underutilized and that in China we sell around one and a half million euros. That's only about 1,200 bikes a year. Considering that the rest of the countries we export from Kunshan account for a total of 15,000 units per year, and that markets like Australia and Japan, where the devaluation of the yen has decreased the purchasing power of the population, it does not have much sense to continue with the manufacturing here" *General Manager of Orbea (Aldama, 2015)*.

IP protection and the risk of brand counterfeiting is often regarded as an external reasons for reshoring (Fratocchi et al., 2016). For Orbea, although this was not a determining factor for their relocating decision, it was a challenge that they had to face in China.

“I have found an Orbea frame, a copy in taobao (Chinese online shopping website). You can be protected and you are protected by law. However, what can happen is that there is someone illegally putting some Orbea copies in the market. And with this one... I mean, you are protected but you cannot avoid it” *General manager of Orbea Kunshan China (Urzelai, personal communication, 25th March 2013)*.

As Fratoncchi et al. (2016) argue, internal organization efficiency is an important reshoring reason. We think that in a spatial reorganization of the reverse process

managers have to be careful. The activities to be relocated must follow an efficiency criteria but they also have to be coordinated with the company's global strategy. In this sense:

“We needed to be more efficient logistically and productively. The scenario had changed and there was a need to reorganized things” *General Manager of Orbea (Aldama, personal communication, 15th April 2015).*

“We had built a relationship with the local government and they respect us because they know that the decisions we adopt had a deep reflection behind. We are with factories of own construction and property (not rented). The government understands that there is a commitment to stay. However, this is something that is changing and firms now, due to the financial situation back in Spain, want to rent the facilities (not buy)” *General Manager general service company of the park (Aldama, personal communication, 15th April 2015).*

“The process is going very well. We met the local government and gave them our explanations on why we have taken this decision. We also went to the labour bureau and have started with the internal communication. On 30th June of 2016 the production activity will stop” *General Manager Orbea (Aldama, personal communication, 15th April 2015).*

Regarding other centres in Australia and the US, during this time the company has also taken some measures due to the supply chain coordination costs and inventory levels there (cost efficiency- internal environmental factors described by Fratocchi et al., 2016).

“In Australia we had a subsidiary with own stock and now we have decided just to have a distribution model. As for the US is concerned we had 1 warehouse in the west coast and 1 in the east coast to attend the manufacturing that was taking place in Asia and Europe, and now we have centralized both of them” *General Manager of Orbea (Aldama, personal communication, 15th April 2015).*

From the perspective of the location in the reverse process, the firm had to choose the location that offers the best conditions for undertaking those activities. In 2015 Orbea found that looking at the location of their most important markets, the production in China (with sales that were lower than expected) did not make much sense.

“Our sales are on an 80% for Europe- US and for and 20% for Latin America -Asia” *General Manager of Orbea (Aldama, personal communication, 15th April 2015).*

The rising costs (especially labour cost) in China were not a factor that determined the decision. However, the monetary situation, and the potential situation where a free trade agreement is signed among Europe, Canada and the US influenced the

new strategy.

Although Orbea has closed the factory in Kunshan in 2015, the company still maintains its activity through distributors.

“We continue and will continue in the Chinese market. We have 40 distribution points here and we will continue working with them; we even continue collaborating with Skoda and we maintain all the agreements that we had. We do not disclaim the option of manufacturing in China, but we have to rethink how to do it. To have our own plant does not have sense” *General Manager of Orbea (Aldama, personal communication, 15th April 2015)*.

Finally, the company needed to reconsider those parts of their value chain that they wanted to keep in in-house or not. The Chinese backshoring decision has reinforced the activities of the HQ and Portugal. The design and know-how is being developed further to give the customers a more flexible and personalized service.

“We have re-organized the manufacturing in Portugal and Mallabia (Spain) and make our home factory in Spain our global center of customization. It is now the center of manufacturing of, let’s say, the bike of your dreams. In a sense, an exclusive bike painted with the colours you want, with the components you want, etc. Due to this we are transferring some manufacturing to Portugal and make investments (we acquired a plant of 9000m in Portugal where we were rented) that allow us be agile and close” *General Manager of Orbea (Aldama, personal communication, 15th April 2015)*.

As a result of this process, Orbea has learnt that being in China nowadays means you need to be looking at the internal market. However, approaching the Chinese market is not that easy and firms should deeply reflect on their strategy before approaching the Red Dragon.

“To stay in China you need to have a strong domestic market. If not, you really need to reflect on that. Coming to China to produce and export that to Europe does no longer have much sense. To produce here you first need to have a domestic market, a volume and neighbouring markets. But of course, the Chinese market is potentially so big that everyone wants to try. Probably other firms must be reflecting about the situation of their production establishments in China” *General Manager of Orbea (Aldama, personal communication, 15th April 2015)*.

6. Conclusions

The objective of this case study was to analyse the role of the place and the space in the international reorganization of Orbea's productive activity. While much of the literature has analysed the offshoring decision from either an economic or a strategic perspective (Ellram et al, 2013), we have integrated both visions into what we call the geostrategic view of offshoring. This geostrategic approach is an original contribution from which we can better understand the intersection between firm characteristics, strategy and location, and its effect on firm performance. The trajectory of the analysed company, which has more than 175 years of history, its leading position in the bicycle industry at a national level and the reputation as one of the most prestigious brands in the world draws some interesting lessons for the future.

The study conducted shows that the determining factors and drivers of the decision to go abroad and return back, are coherent and logic within a strategy, and can be classified as rational. The motivations that led to that decision (search for efficiency and markets) as well as the location in a COO cluster and the entry mode as WFOE (wholly foreign owned enterprise) with an owned plant also seem appropriate. However, after 9 years of activity, the company had to close down. Was it then a bad strategic decision the international reorganization of the production into a cluster in China? We do not think so, the quote that can best justifies this reasoning is the following:

“We were positioned in a medium range price so the influence of the labour cost was not the problem [...]. The tariff barriers did not remove [...] The Euro and the Dollar is almost in parity and there is a free trade agreement (FTA) expectation between US, Canada and Europe [...] the FTA implies that (if put it is put in force), a bike delivered to the US from Europe will be 11% cheaper than delivered from China” *General Manager of Orbea (Aldama, personal communication, 15th April 2015).*

So what lessons can be drawn from this *bittersweet* experience? On the one hand, the best offshoring strategy can be threatened if the *space* does not pro-

vide the expected evolution, as it happened in this case. Although the institutional distance with countries like China has been reduced, and the clustering can offer an adequate investment environment, this was still insufficient. That leads to a first recommendation for managers, who need to be more sensible to the changes in the environment, and question in a systematic way its evolution. The use of scenario analysis or other strategic management forecasting tools could help the managers reduce their uncertainty. On the other hand, an unforeseen evolution of the situation provokes a reactive reformulation of the international strategy. This fact, when it comes to offshoring, is extremely risky not only due to the nature of the investments but also the resources needed. In this sense, a second recommendation for managers is that reshoring and backshoring decisions should be implemented in the most rational way possible. This implies that firms should not base their offshoring decisions just on cost and saving related factors (Kinkel, 2012) but also on more intangible factors such as the valuable knowledge and experience that they had acquired through that international process.

This chapter suffers from several limitations which future research may overcome. First, the sample of firms was drawn from only one case (Orbea in China). One should therefore not generalize the implications of our findings without examining the specific characteristics of the business environment and bicycle sector in China. It could also be interesting to study whether co-location can be used by the firm for future implementations, or it is not considered as a location and entry mode due to that experience gained in China. Second, although the two most relevant managers were interviewed (General Manager of the company and General Manager of the subsidiary in China), the inclusion of other views from people involved in the decision-making process would enrich the research. Therefore, future studies should consider, on one hand, other firms with subsidiaries in China (f. ex. Giant or Specialized) and, on the other hand, more participants from the same firm to obtain a greater consistency in the qualitative data.

References

- Aldama, Z. (2015). Orbea y Fagor Industrial cierran sus fábricas en China. *El Correo*, 16 April, 2015.
- AMBE (Asociación de Marcas y Bicicletas de España- Spanish Association of brands and bicycles) *El sector de la bicicleta en cifras 2015*. Available via: <http://asociacionambe.es/>. Accessed 1 Oct. 2016.
- Bals, L., Daum, A. and Tate, W. (2015). From offshoring to rightshoring: focus on the backshoring phenomenon. *AIB Insights* 15 (4).
- Belussi, F. (2015). The international resilience of Italian industrial districts/clusters (ID/C) between knowledge re-shoring and manufacturing off (near)-shoring. *Journal of Regional Research* (32): 89-113.
- Branstetter, L. & Lardy, N. (2006). *China's embrace of globalization* (No. w12373). National Bureau of Economic Research.
- Buckley, P. J., & Casson, M. (2016). *The future of the multinational enterprise*. Springer. DOI 10.1007/978-1-349-21204-0.
- Buckley, P. J., & Ghauri, P. N. (2004). Globalisation, economic geography and the strategy of multinational enterprises. *Journal of International Business Studies*, 35(2): 81-98. DOI:10.1057/palgrave.jibs.8400076.
- Cantwell, J., & Mudambi, R. (2005). MNE competence-creating subsidiary mandates. *Strategic management journal*, 26(12): 1109-1128. DOI: 10.1002/smj.497.
- Carballo-Cruz, F. (2012). New patterns in global localization: delocalization and relocation of economic activities. Capello R., Ponce Dentinho T. (ed), *Globalization Trends and Regional Development, Dynamics of FDI and Human Capital Flows*. Edgar Elgar, Massachusetts, p 127-154.
- CONEBI (Confederation of the European Bicycle Industry). *European Bicycle Market 2015 edition: Industry & Market Profile*. Available via <http://www.conebi.eu/>. Accessed 1 Oct. 2016.
- Contractor, F. J., Kumar, V., Kundu, S. K., & Pedersen, T. (2010). Reconceptualizing the firm in a world of outsourcing and offshoring: The organizational and geographical relocation of high-value company functions. *Journal of Management Studies*, 47(8): 1417-1433. DOI 10.1111/j.1467-6486.2010.00945.x.
- Coucke, K., & Sleuwaegen, L. (2008). Offshoring as a survival strategy: evidence from manufacturing firms in Belgium. *Journal of International Business Studies*, 39(8): 1261-1277. DOI: 10.1057/palgrave.jibs.8400403.
- De Propriis L. and Driffield N. (2006). FDI, clusters and knowledge sourcing. In: C. Pitelis, R. Sugden and J.R. Wilson, eds. *Clusters and globalisation: The development of urban and regional economies*. Edward Elgar Publishing Inc, Cheltenham, p. 133-158.
- Dikova, D., & Brouthers, K. (2016). International establishment mode choice: past, present and future. *Management International Review*, 56(4): 489-530. DOI 10.1007/s11575-015-0258-3
- Dunning, J. H. (1988). The eclectic paradigm of international production: A restatement and some possible extensions. *Journal of international business studies*, 19 (1): 1-31. DOI: doi:10.1057/palgrave.jibs.8490372
- Ellram, L. M., Tate, W. L., & Petersen, K. J. (2013). Offshoring and reshoring: An update on the manufacturing location decision. *Journal of Supply Chain Management*, 49 (2): 14-22. DOI: DOI: 10.1111/jscm.12019
- Fernandez, J. A., & Underwood, L. (2006). *China CEO: Voices of experience from 20 international business leaders*. John Wiley & Sons, Singapore.
- Fratocchi, L., Ancarani, A., Barbieri, P., Di Mauro, C., Nassimbeni, G., Sartor, M., & Zanoni, A. (2016). Motivations of manufacturing reshoring: an interpretative framework. *International Journal of Physical Distribution & Logistics Management*, 46(2): 98-127. DOI 10.1108/IJPDLM-06-2014-0131.

- Gray, J. V., Skowronski, K., Esenduran, G., & Johnny Rungtusanatham, M. (2013). The reshoring phenomenon: what supply chain academics ought to know and should do. *Journal of Supply Chain Management*, 49(2): 27-33. DOI: 10.1111/jscm.12012.
- Jensen, P. D. Ø., & Pedersen, T. (2011). The economic geography of offshoring: the fit between activities and local context. *Journal of Management Studies*, 48(2): 352-372. DOI: 10.1111/j.1467-6486.2010.00967.x.
- Kedia, B. L., & Mukherjee, D. (2009). Understanding offshoring: A research framework based on disintegration, location and externalization advantages. *Journal of World Business*, 44(3): 250-261. DOI: doi:10.1016/j.jwb.2008.08.005.
- Kim, J. U., & Aguilera, R. V. (2015). Foreign location choice: review and extensions. *International Journal of Management Reviews*, 18(2): 133-159. DOI: 10.1111/ijmr.12064.
- Kinkel, S., & Maloca, S. (2009). Drivers and antecedents of manufacturing offshoring and backshoring—A German perspective. *Journal of Purchasing and Supply Management*, 15(3): 154-165. DOI:10.1016/j.pursup.2009.05.007.
- Kinkel, S. (2012). Trends in production relocation and backshoring activities: Changing patterns in the course of the global economic crisis. *International Journal of Operations & Production Management*, 32(6): 696-720. DOI 10.1108/01443571211230934.
- Lahiri, S. (2015). Does Outsourcing Really Improve Firm Performance? Empirical Evidence and Research Agenda. *International Journal of Management Reviews*, 18(4): 464-497. DOI: 10.1111/ijmr.12075.
- Larsen, M. M., Manning, S., & Pedersen, T. (2013). Uncovering the hidden costs of offshoring: The interplay of complexity, organizational design, and experience. *Strategic Management Journal*, 34(5): 533-552. DOI: 10.1002/smj.2023.
- Martinez- Mora, C and Merino, F. (2014). Offshoring in the Spanish footwear industry: A return journey? *Journal of Purchasing and Supply Management*, 20 (7): 7-8. DOI:10.1016/j.pursup.2014.07.001.
- Morschett, D., Schramm-Klein, H., & Swoboda, B. (2010). Decades of research on market entry modes: What do we really know about external antecedents of entry mode choice?. *Journal of International Management*, 16 (1): 60-77. DOI:10.1016/j.intman.2009.09.002.
- Ochoa, C and Arana, G. (2007) *Orbea, la fabricación y venta de bicicletas*. Casos de gestión avanzada: Foro Conocimiento Empresa- Universidad. Innobasque. Zamudio.
- Pangarkar, N., & Yuan, L. (2009). Location in internationalization strategy: Determinants and consequences. *Multinational Business Review*, 17(2): 37-68. DOI: 10.1108/1525383X200900009.
- Puig, F., Portero, B., & González-Loureiro, M. (2016). Clustering strategy and development of subsidiaries in China. *Economía e Política Industrial*, 1-23. DOI 10.1007/s40812-016-0062-5.
- Puig, F., & Marques, H. (2010). *Territory, specialization and globalization in European manufacturing*. Routledge, New York.
- Tan, D., & Meyer, K. E. (2011). Country-of-origin and industry FDI agglomeration of foreign investors in an emerging economy. *Journal of International Business Studies*, 42(4): 504-520. DOI:10.1057/jibs.2011.4.
- Tate, W. L., Ellram, L. M., Schoenherr, T., & Petersen, K. J. (2014). Global competitive conditions driving the manufacturing location decision. *Business Horizons*, 57(3): 381-390. DOI: 10.1016/j.bushor.2013.12.010.
- Ulrich, A. M. D., Hollensen, S., & Boyd, B. (2014). Entry mode strategies into the Brazil, Russia, India and China (BRIC) markets. *Global Business Review*, 15(3): 423-445. DOI: 10.1177/0972150914535066.
- Urzelai & Puig (2016a) Overcoming liabilities in internationalization process through co-location and social capital. *XXVI international conference ACEDE*. Vigo, Spain, 26-28 June 2016.

- Urzelai & Puig (2016b) Disentangling the place of MNEs through international social capital: the role of communities of practice. *42nd Annual EIBA Conference: Liabilities of Foreignness vs. the Value of Diversity*. Vienna, Austria, 2-4 December 2016.
- Yin, R.K. (2009). *Case Study Research-Design and methods*. Forth Edition. SAGE publications. California.
- Za, V. (2014). The lure of cheap Chinese manufacturing is fading for European companies. *Business Insider* [online]. Available via <http://www.businessinsider.com/r-euro-zone-companies-come-home-as-asian-costs-rise-2014-12>. Accessed 14 March 2017.

DRAFT