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ModusLink Feature Article

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Buying into the Right Global Sourcing Strategy

Tackling the who, what and where for profitability

By Christine Pothier, Marketing Manager, ModusLink

As geographical boundaries that once hampered trade begin to fade and technology continues to compress time and trivialize distance, the impact on manufacturers and their suppliers has been profound and immediate. In today's well-connected world, manufacturers are compelled to take action in pursuit of greater operating efficiency, time to market, customer satisfaction and, of course, cost savings. And with good reason, the market is filled with reports from procurement leaders who generated cost savings ranging from 5 to 15, even 30 percent from global sourcing strategies anchored in a formal strategy.

Once seen as tactical, global sourcing has become a competitive necessity touching all companies, regardless of size, location or product. In fact, a recent report from Aberdeen Group states that 94 percent of manufacturers think global sourcing is important, very important or critical to the success of their companies.

Yet global sourcing continues to operate outside main stream business processes, buried in spreadsheets, emails and applications that are invisible to the greater organization. Many companies have yet to reap the full potential of their global sourcing strategies, failing to integrate all of the sourcing requirements of their far-flung global operations.

Successful global sourcing is not as simple as merely moving production and procurement from higher cost countries to lower cost regions. It's now part of a more sophisticated business discipline grounded in the ever-present realm of "total cost of ownership (TCO)."

Each step in the sourcing process raises a multitude of extremely complex cost challenges. Manufacturers doing business around the world with multiple suppliers are constantly challenged to calculate their total costs in an efficient and accurate manner. It is a complex calculus, helping to ensure that global sourcing strategies are achieving the desired results.

Cost reduction is a key driver and motivating force, but certainly not a guarantee. As with any outcome worth pursuing, there are many risks and challenges that can prevent companies from realizing the full potential of their global sourcing strategy.

Challenges You Didn't Buy into

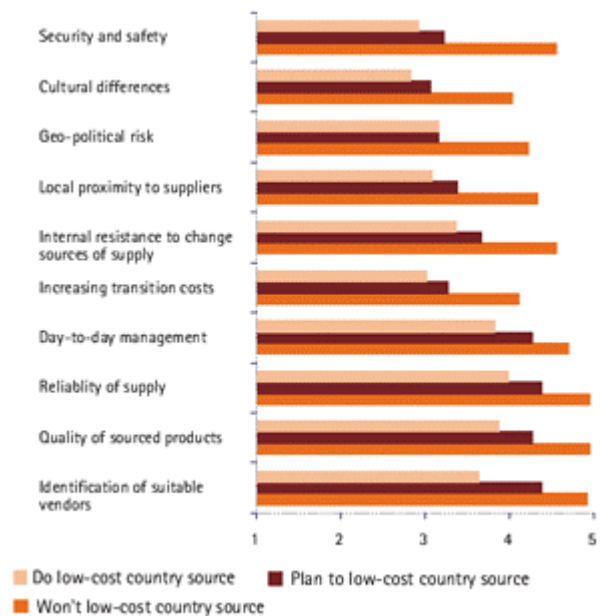
Some of the key challenges frequently discussed in the context of global sourcing include concerns about longer lead times; product quality; vendor reliability; security; lack of knowledge about global suppliers; cultural differences; and geo-political instability.

According to a recent [Accenture study on low-cost country sourcing \(LCCS\)](#)ⁱⁱⁱ, the greatest concerns cited by both those who are currently leveraging LCCS and those who "won't" related to reliability, quality and the identification or knowledge of suitable vendors.

But, at the end of the day it all comes down to cost and whether the cumulative affect of all these concerns and challenges will negate an organization's ability to achieve the cost reductions it seeks. Concerns over "hidden" costs that result from international freight and transportation; customs requirements; additional tax, tariff and duties; additional inventory carried; administrative management; and other "landed costs" associated with the entire sourcing process dominate any conversation about global sourcing.

In fact, the benefits and challenges associated with global sourcing, and its golden child low-cost country sourcing, have been debated ad infinitum in the news and around conference tables and watercoolers, and most people now have a thorough understanding of the dynamics involved. The more pressing issue is how to deal with these challenges and costs to sustain maximum profitability.

While each sourcing strategy will differ based on your company's specific goals, needs and global production model, included are some basic parameters that can give you a better understanding of how global sourcing is best leveraged in the marketplace. The rest of this article will focus on strategies and processes that will help mitigate the risk involved and keep total landed costs from eating away at your profitability.



*Chart From a Low-cost Sourcing Study Published by Accenture in 2005

Delivering on the Promise

“The Where” — Selecting the Sourcing Destinations.

We touched on the concerns about LCCS earlier, but the fact is, there is no question that procuring goods and materials in low-cost countries, like China and the Czech Republic, is a necessary and justifiable sourcing strategy when done correctly. The in-depth study by Accenture found that 86% of companies that engaged in LCCS reported being satisfied with their experience based on total cost. In that same study, respondents cited a 16% incremental savings and predicted that number to increase to 22% in three years time.

China is one of the most talked about destinations for global sourcing due to its low-cost labor, trade-friendly policies and strong tax, tariff and duty incentives. According to global research and consulting firm, A. T. Kearney, 72% of the global companies it studied plan to source from China by 2009 — a rise from less than 30% in 1999 — and 59% plan to source from Eastern Europe.

These numbers substantiate Accenture’s findings which indicate that the preferred low-cost country source for both U.S. and European Union companies is China, followed by India and the Czech Republic, respectively.

The key to achieving success in these regions is to carefully select which materials and goods can be cost-effectively sourced there.

“The What” — Selecting the Products.

To purchase wisely, you need to buy the right quality, quantity and mix of materials at the best possible price. To make this determination, every successful sourcing strategy must address one key question: Which products, or categories of products, are best suited to global sourcing?

Labor-intensive products, such as textiles and clothing, have been sourced overseas for many years due to the impact of low-cost labor on final price. But, with increased frequency, the bulk of products sourced from lower cost destinations are comprised of high tech goods. In fact, countries like China are now the primary suppliers — and in some cases the only suppliers — of a number of commodity hardware materials required for final assembly. This is primarily due to the ability of Asian suppliers to offer these commodity goods at unmatched prices even when total landed costs are factored into the equation.

For example, China and Taiwan produce approximately 40% of the world's power supplies and satisfy 33% of the world's requirement for switches; and by the end of 2006, the region will control 50% of the global trade for circuit and heat protection components, including heatsinks, cooling fans and circuit breakers. These facts appeared in 2005 research reports by Global Sources, a business-to-business exchange and media company, and represent just a modicum of the success and influence of this region.

Weighted Preferences of top three Low-Cost Countries*
% of respondents top three low-cost countries

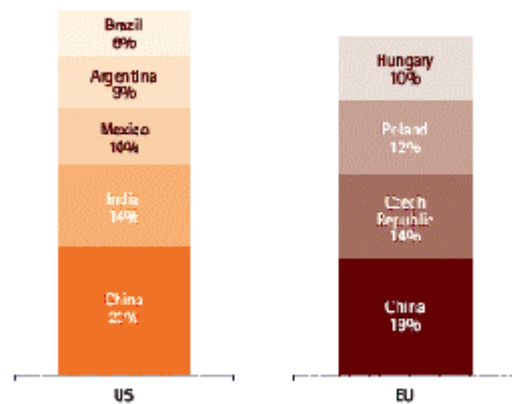


Figure 11: China is the preferred low cost country source
** Chart from a Low-Cost Sourcing Study published by Accenture in 2005.





While just about any product can be sourced cheaply in China, the cost of shipping the goods back to your manufacturing plant could negate any cost savings. For example, commodity materials used for packaging, such as corrugated boxes, clam shells and shrink wrap, usually benefit from near-site, or local, supply sources within each region of operation. Consider the “dead space” you would be paying for by filling a 40-ft. container with corrugated boxes or bubble wrap as opposed to one-inch power adapters. After all, it’s the same cost to ship the container regardless of which products fill it.

It is important to carefully evaluate your sourcing requirements to determine which goods will benefit from offshore suppliers. Consider products with a more constant price structure, less risk of price erosion and susceptibility to frequent price fluctuation in response to market dynamics. Additionally, goods with long life-cycles are better able to withstand the longer lead times and time to market challenges. Lastly, give general consideration to the cost, size and make-up of the products in relation to shipping process and cost.

By aligning the right mix of products with the right combination of offshore and near-site suppliers, it is possible to achieve real cost savings. But how do you find the right mix of suppliers?

“The Who” — Selecting the Vendor.

One of the best ways to combat concerns over reliability, quality and security is choosing the right suppliers. You need to understand the strategic significance of your suppliers and the role they play, based on the products they provide. These roles range from providers of non-core components, like packaging materials to strategic partners, who supply raw materials or critical value-add items to the finished good.



When you start your search for suppliers, your best weapon is knowledge. Find out what suppliers are being used by others in your industry — vendors will usually be glad to share this information with you; otherwise, it can be found, lightly-cloaked, in their marketing materials. You can also leverage trade publications, industry trade exchanges, brokers and supplier consortiums to get you started. For example, earlier mentioned Global Sources is an active online exchange community facilitating trade with Greater China. With an active community of more than 479,000 active buyers and 130,000 suppliers, the exchange offers purchasing information on more than 1.4 million products. www.globalsources.com.

Supply chain outsourcing vendors are another comprehensive resource skilled in helping manufacturers maximize global sourcing for cost reduction and competitive advantage. Be sure your outsourcing partner has an internal purchasing organization (IPO) at their disposal and a worldwide network capable of supporting your manufacturing operations in key regions across the globe.

Of course, identifying sources is only half the problem. The other half is sifting through the good, the bad and the sometimes ugly to make your final selections. Below is a list of the six critical areas that will help you analyze the capabilities of the vendors and help you determine whether they should be put on your “short list.”

1. *Manufacturing Capacity.* Do they have the capacity to produce the volume you need, with room for growth? What is their production cycle time? Do they have applicable certifications relevant to your line of business, such as ISO? Do they have disaster

recovery/contingency plans in place? What security measures are in place to protect IP?

2. *Technology Competency*. What ERP technology are the vendors using? Is it current generation? Do they have the capability to collaborate with you via portals to manage and track inventory? Are the suppliers investing in newer technology?
3. *Financial Stability*. Who else do they work with in your industry? How long have they been in business? Are they profitable and will they be there two years from now? You do not want to have to “develop” a vendor to get them to a place where they can add value and meet your needs.
4. *Quality Assurance*. What is their current track record? What level of quality are they willing to contractually agree to?
5. *Logistics*. How do the vendors handle logistics? What are their DDU policies? How do they deal with loss risk?
6. *Flexibility*. Are the vendors willing to work with you to optimize the procurement process? Are they willing to modify their traditional business models to accommodate your specific procurement needs?

It is important to investigate whether the vendor has the flexibility and willingness to implement value-add supply/inventory management techniques, such as line side stocking and vendor managed inventory (VMI), where and when appropriate. These techniques are highly effective tools for managing long distance vendor relationships, but not always easy to negotiate.

“The Recap”

§ Leverage low-cost country sourcing where appropriate and cost-feasible;

§ Align the right mix of products with the right combination of offshore and near-site suppliers;

§ Utilize market resources and outsourcing partners to identify suppliers;

§ Investigate your suppliers to be sure they can meet your needs for the long term and have the flexibility and willingness to implement value-add supply management techniques where appropriate.

This is a broad stroke review of the key elements of global sourcing. Look for more in-depth reporting on each of these critical factors in future issues, including a comprehensive look at VMI and other inventory/supply management techniques in our next issue.

[1] Several references pulled from *Where East Meets West: Driving High Performance in Low-Cost Country Sourcing*, a report and survey from Accenture, a global consulting management firm, published in 2005.

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