

Sourcing Hotspots

What are the emerging favourites for low-cost sourcing and how best to start? Paul Snell picks up some advice

Low-cost country sourcing (LCCS) is certainly nothing new. From the Roman Republic to the British Empire, nations and businesses have profited from foreign labour and accessing different skills.

And Supply Management readers are just as aware of the advantages. LCCS has ranked highly as one of the "hot topics" for procurement professionals for the past three years. "This is not going to be a three-minute wonder," said Dick Russill, chairing the recent CIPS Trading with China, Brazil and India conference.

But it can be an intimidating subject to approach. Just knowing where to begin, where to go and how to balance the risks are enormous challenges for buyers in the UK, let alone trying to do it thousands of miles away in a country where you don't speak the language.

Entrepreneur and business expert Sir Anthony Jolliffe, who has extensive experience in sourcing and manufacturing abroad, cautions: "There are endless opportunities, but they come with huge risks. What do these countries want above all? They want your money."

Ground work

As with many things, preparation before embarking is critical. As always, how your projects begin will determine their success in the long term.

But before thinking about where you want to go, you must decide what it is you want to achieve. "Start by trying to make a case, as if you were going to a bank," says Rolf Schimrock, partner at sourcing consultancy The Sustainomics Group. One of the first things to ask, he says,

is for extra resources, because it is an intensive process taking anywhere between two and six weeks.

"You need to have procurement people who can dedicate themselves to this," he says. "Purchasing has to take the lead and see how much opportunity there is to capture. This is the most difficult part."

Schimrock recommends dividing your budget into 30-50 categories, to identify where your biggest spends are. Once the biggest potential savings are identified, this should be weighed against the complexity of sourcing these products in a low-cost country.

One way of analysing this is by measuring criteria such as how deep the international supplier market is, the complexity of your product, how sensitive it is and the cost of switching production, from high complexity to low. This will allow you to see how difficult a process low-cost country sourcing will be for each category.

Once this has been completed Schimrock suggests selecting three or four categories of the less complex items to focus on. "Do very little, but do it right," he counsels. "Then you can show a small success story. You do less, but do it deep." Getting support from other departments, in particular senior management, is critical for the process.

Where in the World?

The variety of locations for LCCS are numerous, but knowing where to source can be tricky. But you shouldn't just make a decision based on a single country, let your choice of supplier be the guiding factor.

A screening process for suppliers "that gets tougher at every stage" is one way of determining this. Start by contacting about 100 worldwide suppliers you think might be suitable. This can be based on very general qualities such as their size, experience and overall quality level.

This group can then be reduced to around 20-30. You could invite them to a supplier conference, either in your own or the low-cost country. By doing this, you are building a relationship and demonstrating commitment. According to Schimrock, these psychological factors can lead to better prices, and can add up to 5 per cent to your expected savings.

Meeting suppliers in person can also build lines of communication and reduce the potential for mistakes. "People will jump on you as soon as something goes wrong, so communicate, communicate, communicate," says Schimrock.

After holding the conference, you should be able to shortlist a smaller number of suppliers on price and other criteria such as how the supplier will fit with your company.

It is important to get suppliers to break down their cost structure, so you can evaluate just how you will make savings. Although you might be winning in terms of lower labour costs, you might be losing out in areas such as higher raw material prices.

Having short-listed your suppliers, make sure you complete due diligence, visiting factories and making your final selections for negotiations, just as you would with UK

suppliers.

Tips of the Trade

Once you have selected a preferred supplier, there are a number of techniques you can employ to make your relationship run a little smoother.

First among these is having people you can trust, working for you in that country. "You need to have trustworthy people on your side. Trying to negotiate on your own is tough," says Jolliffe.

This doesn't only mean having members of your own team, or company in the country, but also employing local knowledge and experience. This will help break down the potential language barrier.

The cultural differences in negotiating with suppliers could also present problems. Jolliffe recounts the story of completing a marathon negotiation session with a Chinese supplier, only to leave the room and be told by one of his local employees: "This is where the real negotiations begin."

But this doesn't mean you should settle for substandard deals. "You might have to go back to them three or four times, and have a very strong nerve," he says. "Just remember, they need the business, more than you need the supply."

Mark Payne, director, global infrastructure systems, at manufacturer Honeywell, backs his views: "You need to be prepared to work away," he says. "Most of the time the supplier will be prepared to come back, and come down to the price you want."

In addition to your money, as mentioned by Jolliffe, foreign suppliers often want access to your skills and experience, and offering these as incentives can often smooth the sourcing process. Jolliffe suggests putting your own people on production lines to help with training, or inviting them to observe the processes you use in factories.

He also has some advice for those worried about the protection offered to foreign buyers in low-cost countries: "Always get a local dignitary to sign contracts, because then you can go to the government and say we have a commitment."

But he has not found this to be a common problem when doing LCCS. "If you are showing them commitment, they will show it back."

CSR

And what about ethics and sustainability? Most buyers will have read the horror stories of companies exposed as employers of child labour or worker exploitation. Jane Gibbs, supply chain director at building firm Rok, says good purchasers should have little to worry about, providing they measure the risk. "Be thorough," she advises. "Use the same criteria to identify suppliers, regardless of what country you are sourcing in."

You can't take a "British Empire" attitude of imposing your own values, she adds, but buyers should be practical, sensible and prepared to put in time and money. If you have built trust and your relationship with suppliers, they will be more receptive to new ideas.

It is also beneficial, she says, to alert senior management to the potential risks of LCCS before you begin. Ask them: "What is your exposure?" and "How does it affect your bottom line and reputation?"

The Future

Much of this advice should be familiar to buyers. "You apply the same principles as you would sourcing from anywhere," says John Yard, consultant at John Yard Associates.

Opportunities for procurement are only getting bigger in this area, and not just in the buying process. "We have reached a real milestone in procurement," says Ben Schmitzehe, managing director of The Sustainomics Group. "One of the missed tricks is not to feed the value into the organisation from procurement," he says, suggesting that procurement can transfer its knowledge of low-cost regions to marketing and sales, to aid their entry into the company.

"It is a brilliant catalyst for making wider change," says Russill. "It raises the profile of procurement in the company. The potential downside is of branding procurement as aimed at cost-savings."

And, Russill says, some people have forgotten about calling it LCCS. To these buyers the areas are more effectively described as EPMs - emerging procurement markets.

CASE STUDY

Low cost countries: the major players

We are currently in a "new political economy", according to Mark Berrisford-Smith, senior economist at HSBC. "The mould of the old global economy has been revamped."

In its place comes the "BRIC" - Brazil, Russia, India and China, the four countries expected to dominate the world economy by 2050 and countries that also dominate the LCCS arena.

Berrisford-Smith says many economists now disregard Russia as an economic driver, and he believes that Brazil cannot compete with China and India. "Brazil is a bit-part player and does not fit into the dynamic model of India and China," he said. "Brazil's economic growth is around 2.8 or 2.9 per cent - the UK's is 2.7 per cent."

China is traditionally a manufacturing stronghold and India leads the way on services. Growth in China last year was around 10.7 per cent, with India's around 7 per cent. China holds the advantage in terms of sheer manpower, but India can rely on a strong base of employees with good data and analytical skills.

But new supply markets are emerging. Berrisford-Smith highlights Vietnam, with a growth of 8 per cent last year, as the latest "Asian tiger". And he says the Czech Republic and Poland are potential locations closer to home.

Honeywell's Mark Payne recommends Barbados for low-cost services. In addition to language benefits, he cites the low attrition rate of staff and the very strong work ethic of the country as attractive features.

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