The challenge of Global Sourcing

The trend to globalisation shows no signs of weakening. The purpose of this round table debate was to explore some of the many challenges that global sourcing is throwing up for supply chain operations and for the wider business. By Sam Tulip

What are the key considerations when sourcing from the Far East or other 'low cost' regions? Sigi Osagie of Marconi said ‘We are under market pressure to take out cost and protect margins. We started lower cost sourcing in Eastern Europe though it was always our intention to use Asia. But while sourcing from Eastern Europe is not too dissimilar from sourcing in the West, Asia becomes a whole new ball-game when you consider factors like distribution, and we are having to instil a different mindset across the business: especially, we have to think in terms of landed cost, not just product cost.

And analysing our distribution and consumption “footprints” is a big thing. It may seem fine to move production to Asia – but if 70 per cent of the consumption of a particular product is in say Western Europe, or Latin America, then Asian production may not make sense.

Also, said Osagie, supplier competence and capability have to be looked at in a rather different light. ‘Traditionally we’ve looked at the capability of a supplier company, but we are finding that can be very different from capability assessed at the plant level. Our sources may have top-notch Western factories but don’t necessarily replicate that in their Asian operations’.

Very different dynamics
The equations of service, cost and distance to market have very different dynamics in China than they do in Eastern Europe. Mena reported that Cranfield is working with companies to try to model how they make decisions and assess different risks (for example the risk of Intellectual Property theft) in such markets. But ‘you can’t accurately evaluate a lot of these risks – it comes down to perceptions. It may be, for example that British firms simply feel easier dealing with India than with China; for other nationals the perception may be different.’

Global sourcing undeniably increases supply chain risk. To mitigate this Osagie advocates a multi-functional sourcing approach so that landed costs, volumes, inventory management, ownership issues and all the other factors that are risk-sensitive can be considered together.

‘Logistics Europe’/IBM research (reported last year) appeared to show rising inventory levels, plausibly attributed to the increase in global sourcing. Carlos Mena confirmed that research points to anywhere from 25 to 35 days of inventory being added as a direct result of sourcing at the end of a long sea route. Additionally, said Bill Bundy, the risks of sourcing over long distances prompt increases in buffer stocks, especially where there are onerous customer service level requirements. To mitigate this, UPS is seeing an increase in the use of techniques such as Vendor Managed Inventory, which is another driver for establishing deeper and longer-term relations with vendors.

Obsolescence – a major concern
Obsolescence, especially in high-tech industries, is also a major concern, said Bundy. ‘Companies are looking for logistics models that will shrink inventory, for instance by consolidating buffer stocks in one location rather than all over the place. So we see a lot of requests for bundled or all-in services to comprise air, ocean, warehousing, inventory management, order-to-cash management… That’s definitely a trend. But at the same time firms always have a tendency to push for lower costs in particular segments, which works against the single logistics supplier approach.’

So where should the responsibilities lie in a global sourcing network? Osagie said ‘When you look at what happens across a supply network, a manufacturer or supplier has a competence in production, but not necessarily in managing inventory. The OEM’s competences are probably in design, marketing, sales. What happens in between? There has to be an evolution from a ‘OEM + Strategic Partner + Logistics Expert’ model to a tripartite relationship – OEM + Strategic Partner + Logistics Expert’.

‘For 3PLs’, suggested Mena, ‘there may be great opportunities to act as brokers, to make marriages between OEMs and suppliers. Probably not directly sourcing on behalf of OEMs, but as the experts in moving product and managing inventory, they have to deal with the relationship between OEM and supplier anyway, so why not be involved in setting that relationship up?’

UPS hasn’t gone that far yet, said Bundy, but ‘we might well have the people with that expertise, and 3PLs are necessarily going to be more engaged with them than they currently are. Things like Vendor Owned Inventory involve step changes in operation – order processing becomes vital because it controls when ownership changes’. Osagie suggested that 3PLs might well become the effective supply chain managers – ‘I can focus on the market and let my strategic logistics partner worry about movement’.

They may also need to worry about data. Carlos Mena said that there is real and justifiable concern about some countries...
as to, not only the piracy of Intellectual Property, but also where customer data ends up – there have been examples of customer demand forecasts being sold on. Osagie noted ‘the more you integrate systems and extend the information supply chain, the harder it is to ensure integrity’. Bundy agreed that ‘the movement of product, information, and funds all has to be synchronised, reliable and dependable. When customers are looking for a bundled, integrated solution, that’s one of the things they must focus on’.

Is Quality an issue? Carlos Mena suggested that product quality is often just as good as from European or American sources, but there is assumed to be a higher risk simply because less is known about the supplying company. Hence the importance of having local contacts and working through local people. Bill Bundy added that ‘where we apply technology, they (the Chinese) throw labour at the problem. That doesn’t necessarily impact on quality, but it requires a different mindset to appreciate. Controlling quality – of products and of processes – at a distance is a definite challenge. Osagie says ‘When we started low cost country sourcing we had to shift our mindset, and also our idea of our own core competences, especially in back office areas. Our quality engineers can’t just walk down to the shop floor any more – the assets are not only far away but they belong to somebody else – if you want a sample you have to raise a Purchase Order! You have to include this sort of thing in your multi-function sourcing decisions, along with factors like test equipment, fixtures and so on. If two products share some of the same equipment and you are outsourcing one of them, do you duplicate the equipment, or do you have to move production of the other product as well? ’

’Each time we make a move we have to assess not just the sourcing, but the capital effects. Then we have to manage the required technology transfer almost as a business in itself, so my role switches from one of making sourcing decisions to one of supporting the move. ’

’Quality is a big thing obviously and if that means posting quality engineers to Asia to work with a partner for three months then we have to do that, but that local presence, along with the increased costs of the normal audits, are hidden costs that have to be considered’.

Reputation and the brand
Mena pointed out that some companies have staff permanently based within their overseas suppliers, or at least for extended periods during production start-up or new product introduction. Osagie emphasised ‘it’s still your reputation and your brand. As the product goes through the life cycle you may get to the point where production becomes run of the mill and you can begin to take quality for granted’, but especially in High-Tech, many products may not reach that point before they are superseded.

Ensuring quality production in a low cost country is one thing; getting it to market on time is quite another. Bundy noted that higher end/short-shelf-life production tends to come out of Asia by air ‘but at peak times there is no lift available’ and Osagie confirmed this. ‘It seems as though the service providers are the key players and the OEMs just feel the pain. What is being done by 3PLs to ramp up freight capacity, especially given the growth rates of for example China, Malaysia and Indonesia?’ Bundy explained that UPS and others try to increase capacity, for example, by using larger planes and to manage peak demand by using variable cost/price models – although he conceded that these are difficult for customers to deal with. But a lot is down to governments – an increase in landing rights for an operator typically requires government-to-government agreement (which may tend to favour state passenger operators over private freighters). Osagie asked whether we needed an international equivalent of the Freight Transport Association to lobby governments. ‘It’s logical to assume that a ramp in infrastructure would make it

The panellists:
Under the chairmanship of Nick Allen, Editor of Logistics Europe, around the table were:

Bill Bundy, a Texan, has spent his whole career with UPS, where he is currently Supply Chain Solutions operations director, EMEA, based in Switzerland.

Sigi Osagie has been with Marconi Corporation plc for six years and is their director of Global Logistics, with sourcing forming a major part of his role.

Dr Carlos Mena is a senior research fellow at the Centre for Logistics and Supply Chain Practice, Cranfield School of Management.
are waking up to the possibilities offered by China and other countries not just as sources but also as markets. ‘We are positioning ourselves for flows of goods back to China. Over the next 10-15 years a large and expanding middle class will want goods – toiletries, videos, books, for example – that Europe can provide. I was very surprised by a recent survey of European executives in which everyone was seeing China as a big market opportunity – except for those in the UK. The Olympics will make a statement that we can’t ignore’.

Carlos Mena cited the huge proportion of French-bottled Evian water that now goes to China – aided of course by the purely nominal shipping rates available for backflows to China. India too has a huge emerging market, although government policies and infrastructure deficiencies have been problems.

Consideration of Africa’s problems raised another area of supply chain risk which the panel didn’t have time to discuss – along with the whole question of ethics and corporate social responsibility, which is or should be central to sourcing decisions. A huge topic, and one perhaps deserving of a Round Table in its own right.

What about other regions?

Where is the end-game for global sourcing? Osagie pointed out that ‘If we had had this conversation fifteen years ago, we would probably have been talking about Latin America. Now it’s all about Asia. Is there a dynamic that could give Africa a potential as a sourcing destination? If, for example, Asian infrastructure remains overloaded and Africa sorted some of its own problems out? In a small way that is happening at least in the North – Morocco and Tunisia as sources for the apparel industry, for example. But the attraction of a region is not just about its capability as a source; it is also increasingly about its potential as a market – one reason why Russia didn’t figure in this discussion: despite its huge resources, as a market it’s smaller than Mexico. Bill Bundy suggested that companies easier for western companies to source in, and get products out of these countries which would benefit those countries in the long run – but do Asian governments see that?’

Left to right: Dr Carlos Mena and Nick Allen

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