

Global Sourcing – Critical Steps in the First Phase

Robi Bendorf, C.P.M., Consultant
Bendorf & Associates, (www.bendorf.com), Monroeville, PA 15146-4735,
412/856-4453, robi@bendorf.com

Getting the greatest value for every dollar spent has become a common business imperative that has top management asking the question “are we buying from the best place in the world?” Those who know the answer have added an exciting and challenging aspect to their career. The purpose of this presentation is to improve the productivity and success of those new to global sourcing initiatives by outlining a process for implementing international purchasing based on the experiences of those who have “been there, done that”.

The Global Sourcing Process. Although a chapter of consider length could be written about each of the following listed 18 steps in the Global Sourcing Process, our objective in this presentation is to simply introduce the process and provide some basic pointers from those who have had considerable experience in using it. It is strongly recommended that you take advantage of the many excellent NAPM articles and seminars in order to continue to build your global sourcing skill set.

1. Obtain Senior Management & Cognizant Personnel Support. It is very important, once senior management commitment is obtained, to also get the support from engineering, quality, marketing, HR, finance and any other function that may be involved or impacted. Getting these commitments is a must since you should not continue without the support of all cognizant activities. There have been cases where months of work and thousands of dollars have been wasted because an engineering or quality department was not committed and therefore would not even evaluate a part from an overseas supplier. Make sure that all involved functions have the time to support your global initiatives and have budgeted for the additional expense involved for tooling, travel and testing.

2. Select Products. A method for evaluation and selection parts should be developed for the initiative. A typical method would include the following steps:

Step A. ABC analysis. Only the "A" category parts, those usually making up 80% of the Dollars but less than 20% of the parts, should be considered. As a general rule there is usually insufficient savings to justify the cost and risk to go global on items with less than \$100,000 in annual activity. Delete parts that are proprietary, subject to frequent design change, or have manufacturing, quality or design problems.

Step B. Group by Process. Organize the selected parts by manufacturing process, e.g. casting, stamping, machined part, assembly, etc.

Step C. Rank by Potential Savings. Develop potential savings by cost analysis. Use information like the comparison of hourly labor rates for selected countries published by the U.S. Bureau of Labor Statistics.

Step D. Select Parts for RFQ. Select 1 or 2 of the highest potential savings parts from each Group for the pilot RFQ.

3. "Come to-Know" Analysis. Most of the difficulties in taking parts made domestically to foreign locations occur because of the many things that you and the present supplier have "come to know" about the item that have never made it to the drawing or specification. Every part seems to have these "come to knows" and it is essential that you define what they are before the RFQ package goes out. It is best to hold a "come to know" meeting with everyone who has anything to do with the part. At this meeting compare actual parts to the drawing and specification, identify inspection methods that must be used by supplier and confirm that the same method and equipment will be used by your company. Are there drawing or specification requirements that are not currently being met by the present supplier that should be eliminated? Have sample parts, which will be sent to the supplier, been inspected against the current drawing? Have addresses, fax numbers, and contacts been identified for domestic suppliers who are specified in drawing and specification.

4. Select Sourcing Approach. Depending on the estimated dollar volume, potential savings, the international purchasing experience level, and the resources available, one of the following Global Sourcing approaches should be selected:

US sales contact of foreign suppliers
US global sourcing company

Overseas sourcing representatives
Direct to supplier

Each of these approaches has benefits and disadvantages. For example the following represents the services provided, the advantages, and major disadvantages of using an Overseas Sourcing Representative (OSR):

Services Provided by Overseas Sourcing Representative
 Understanding the purchaser's requirements.
 Finding and qualifying potential suppliers.
 Helping potential suppliers understand requirements.
 Obtaining Quotes.
 Negotiations with suppliers.
 Arranging for evaluation visits by purchaser and escorting purchaser while in country.
 Insure order entry.
 Resolve Issues.
 Facilitate communications.
 Expedite for delivery.
 Resolve any quality issues.
 Orders can be placed on OSR who will place on Supplier.
 OSR can make payment to supplier.
 OSR can perform inspection.
 OSR can take full quality responsibility.

Advantages Overseas Sourcing Representatives
 Shorten search & response period.
 Work on Commission.
 Generally know reputations of the suppliers.
 Can find small obscure suppliers.
 Know the Customs & Culture.
 Act as in country escorts and make in country visits much more productive.
 Improve negotiations.
 Perform inspection.
 Expediting & Communication assistance.
Major Disadvantages of using OSR
 Add to direct material cost (5% to 20%).
 May limit number of potential suppliers.
 Difficult to select OSR.
 OSR most receive successes for continued relationships.
 May be paid by the suppliers as well .
 Difficult to remove from supplier/purchaser relationship.

5. Target Potential Supply Countries. First understand what your objective is for overseas sourcing, price, quality, capacity, technology, strategic, and then determine which countries will best meet the objective. An excellent place to search is the US Department of Commerce's

National Trade Data Bank (NTDB) which has an almost unbelievable amount of trade and country information. For a very small annual fee you can get the NTDB on line (www.stat-usa.gov) or on CD. An easy approach is to search the NTDB for the major countries of US imports for the products you are interested in.

6. Locate Interested Sources. Once you have identified the potential countries and determined that your best approach to international buying is to go direct instead of using the 3rd parties discussed in step 4, you are ready to identify potential suppliers. Besides antidotal information from other company buyers, the following is a list of sources for locating potential suppliers:

Trade promotion offices of target countries
Fairs & Trade Shows
Trade Journals
Country or Region Directories
Overseas Major City Yellow Pages

US Banking Branches of Overseas Banks
The Internet
Your Companies overseas selling Office
US Department of Commerce
International Purchasing Offices of friendly US companies

Once you have identified potential suppliers, send polite faxes giving a description of your company, some details of the items you are searching for, request that they respond with their interest in receiving a formal RFQ, and that they provide basic information about their company. Do not be surprised if you do not get a large response. One company sent out over 500 faxes and received only 30 responses.

7. Develop Inquiry Packages. This is a very important step that often receives too little attention. It is surprising how often RFQs are issued by companies, who are insisting on top quality from their suppliers, but who send out very poor quality RFQs. Make sure that the drawings are easily readable, that every drawing and specification referenced is included in the RFQ package. Include all referenced non-company documents such as government and industry standards. Make sure that cleaning, packaging and packing requirements are clearly defined. Be sure and specify not only the estimated annual quantity, but also the release quantity of each shipment. Clearly identify what information you will want to receive with the proposal so that you can perform the preliminary supplier evaluation.

If the supplier is in a country with an easily convertible currency, ask for prices to be quoted in the supplier's currency. Be sure and ask the supplier to identify the nearest port and request that he includes the size, weight and quantity of each box to be shipped. Become familiar with the ICC Incoterms that define the responsibilities of buyer and seller in international shipments. Obtain advice from experienced international shippers for the best terms to use in your situation. Be prepared to receive a lot of questions from the suppliers. It is best to provide telephone numbers and times when you can be reached during the supplier's workday.

8. Obtain Supplier Quotations. Make sure to ask to receive quotes in writing and by Fax or email. Send polite faxes to suppliers who are late with bids, asking them if they need help in quoting and also to confirm their interest in bidding by advising when the quote will be sent. If possible wait to receive all proposals before obtaining freight and import costs so that you can do this all at once for all bids received.

9. Determine Freight & Import Costs. Using the total package weights and sizes you received from the suppliers (be sure they are consistent with your own estimates), contact ocean freight and/or air freight carriers to obtain pricing. Select a Customs Broker who will eventually handle all the details of the import process, but at this point, will assist you in determining the import duty and the other charges applicable to the shipment and the import process.

10. Develop Delivered Price. Develop a spread sheet application that will allow you to easily calculate the final price based on the many variables you will encounter. The following is an example of the typical output:

| | | | | |
|-----------------------|-----|------|------|-------|
| Release Qty | 1 | 10 | 50 | 100 |
| Unit Cost | 80 | 80 | 80 | 80 |
| Order Cost | 80 | 800 | 4000 | 8000 |
| Customs Duty | 6 | 56 | 280 | 560 |
| Dock Fees | 20 | 20 | 26 | 51 |
| Broker Fees | 100 | 100 | 100 | 100 |
| L/C Fee | 185 | 185 | 185 | 185 |
| Ocean Freight | 100 | 100 | 375 | 750 |
| Insurance | 1 | 2 | 12 | 24 |
| Inland Freight | 50 | 80 | 400 | 500 |
| Overseas Sourcing Rep | 2 | 16 | 80 | 160 |
| Miscellaneous Costs | 10 | 20 | 60 | 110 |
| Delivered Cost | 635 | 1379 | 5648 | 10440 |
| Unit Del Cost | 635 | 138 | 112 | 104 |

The table reflects not only the most common additional external cost in international buying, but also is designed to show the significant impact on the final unit delivered price by the quantity being shipped.

11. Perform Supplier Evaluation. Although many companies place orders with overseas suppliers without formal supplier evaluation, most experienced international buyers would find placing business with an overseas supplier without an on site evaluation to be unconscionable. Make sure the right people go to make the evaluation. All too often the company's "big wigs" go and leave behind those who really know the product and are in the best position to evaluate the supplier.

12. Resolve Technical, Commercial & Quality Issues. A good time to do this is during the on site evaluation visit. It is really important to resolve these issues in writing even if the supplier's personnel seem to have a good grasp of English. It is not unusual for foreigners to have much better reading and writing skills in English than their speaking and listening skills. Some cultures are reluctant or embarrassed to say that they do not understand you and therefore will agree even when they are not sure what was said.

13. Write & Place Contracts. Besides the standard stuff you would put in any Purchase Order or Contract you should include specifics related to the following in any international order:

- You should identify the Harmonized System Code for each item being ordered, so that it is not left up to the supplier or the Customs Broker to decide upon import.
- Clearly specify the shipping and routing method. Identify the Ship to and markings required on each box.
- Require that a packing list be sent to you separate from the shipment.
- The payment method should be clearly identified. If a Letter of Credit is to be used, specify what documents must be submitted before your bank will authorize payment. It is best to require at least all the documents that are required for the import process.

Carefully review your standard terms & conditions. The clauses related to rejections, disputes, payments, and governing law might have to be changed. If the supplier's country is a signatory to the Convention on Contracts for the International Sale of Goods (CISG), then the provisions of CISG will apply unless you specifically state in the contract or purchase order that CISG does not apply.

Notify unsuccessful bidders by thanking them for their efforts, and explaining what might make them successful with your company in the future.

14. Issue Letters of Credit, if required. Letters of Credit (LC) are a very common method of payment in international transactions. They can easily be arranged with your bank, which usually will have a standard application for you to complete. It is important to note that when the bank issues the LC on your behalf, they will deduct the amount from your company's available line of credit, even though the money will not be paid out until shipment occurs. For companies with cash flow problems, this could be a compelling reason not to issue a LC.

15. Order Administration. Know the supplier's production process and schedule and check frequently for status. When checking status, be sure and ask questions that can only be answered with data that would indicate the particular production step had been completed. One of the biggest problems overseas suppliers have with US companies, once the project is underway, is our lack of timely response to their questions. Set an objective of 1 day turnaround for supplier questions.

16. Provide Shipping Instructions. Do not leave the shipping methods, routings, and selection of carriers up to the supplier. If these were not provided in the order, it is important to give the supplier formal shipping instructions as they approach the time for shipment. Discuss with your Broker, freight lines, and others who have shipped similar products to obtain the most reliable methods. Using the wrong carriers can lose many days or even weeks.

17. Pay Supplier. Whatever the payment method (open account, LC, cash against documents), make sure that you pay on time in accordance with the agreement. Our overseas suppliers do not appreciate our standard story about a foul-up in accounting.

18. Handle Export, Shipping, & Import Details. You have done a great job getting it to this point so don't stop now. Make sure that you have identified who has responsibility for this phase of the project. Do they have the proper training. Develop a checklist like the following:

Prior to Shipment

- Fax Request for Current Status
- Advise cognizant INTERNAL personnel of current status
- Review Shipping & Payment Terms

- ❑ **Confirm that Supplier will include any assists in shipment value**
- ❑ **Confirm that Supplier will use buyer supplied US Customs Harmonized Number in Shipping description**
- ❑ **Specify to Supplier Transportation Method**
- ❑ **Confirm Consignee, Notify Party, Port, & Markings and that buyer will receive copy of shipping papers**
- ❑ **Specify Forwarder & Broker if not included in P. O.**
- ❑ **Confirm that Supplier or Forwarder has Routing**
- ❑ **Confirm that Transportation has been arranged**
- ❑ **Confirm that Freight Rates used in original landed cost estimates are being used**
- ❑ **Confirm Certificate of Origin (Form A) is Complete**
- ❑ **Is an inspection certificate required & if so, is it complete**
- ❑ **Confirm Special Packaging arrangements**
- ❑ **Confirm Hazardous Cargo Compliance**
- ❑ **Consider strikes or any other significant International events that may cause delay**
- ❑ **Confirm that procedure for transportation insurance coverage is being followed**

After Shipment Leaves Supplier

- ❑ **Confirm that Freight Forwarder has freight and that booking was made**
- ❑ **Confirm Shipment is on intended vessel/flight**
- ❑ **Determine if pre-clear through US Customs is possible**
- ❑ **Check Documents received to insure correct consignee, notify party & destination**
- ❑ **Confirm Forwarder has sent copies of Documents to Buyer & Broker**
- ❑ **Confirm Broker has all necessary documents**
- ❑ **Prepare info for special clearances such as FDA if required**
- ❑ **Confirm arrival with broker**
- ❑ **Confirm Custom clearance with broker**
- ❑ **Obtain pro number, trailer number, name & phone number of inland carrier**
- ❑ **Confirm inland delivery with inland carrier**

When you have completed this process give yourself and your team a well deserved congratulations and from those of us who have "been there, done that", we welcome you into an elite group of purchasing professionals who have added a broadening, exciting and challenging aspect to their careers.