

## **Low Cost Country Strategic Sourcing**

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**Abstract.** Many CPOs are reviewing the opportunity and challenge of globalization and the effect it will have on their extended enterprise. The supply chain organization must put focus on the global economy in order to understand the new risks and opportunities associated with it. A focused effort on the international transformation will highlight the need for leading edge sourcing strategies of which the fittest will survive. A robust process that integrates the low cost country objectives and mitigates the associated risks is necessary to optimize the value stream. As part of this process, an analysis of total cost will define the cost drivers for the particular product or service to be sourced. This, along with demographics, the health of the country's economy, global relationships, and the organizational strategy will drive sourcing decisions. Overall, there are many risks, opportunities and challenges that need to be understood in order to optimize sourcing decisions in a global economy.

**CPO Strategy.** The global economy is ever changing and supply management is a key constituent who should maximize the benefits it provides. The A.T. Kearney Center for Strategic Supply Leadership at ISM (The Center) recently brought together 30 senior supply management executives for a summit; one focus area was globalization. The CPOs discussed supply management's role, risk mitigation, maximization of value in the supply chain and global business along with the amplification of these elements in the future. In order to define a global strategy, there are several dimensions that the CPO needs to consider. Think of a three-dimensional cube, with the three axis representing complexity, global opportunities, and whatever dynamics are evolving in any given industry. In the future, this cube becomes bigger and additional layers are created. Strategies need to be developed with these three dimensions under consideration.

There are multiple layers to consider when reviewing the complexity dimension. They include the influence of internal functional areas, the multi-dimensional supply chain, and the customer. The CPO must influence key business partners and collaborate effectively in order to maximize value to the organization. The strategies of each function need to be aligned with the overall global strategy of the organization. The measurement systems used should measure total effect on the organization and not be reflective only of one aspect of total cost or one function. This can create an internal global synergistic network of which the CPO can be the primary integrator and whose strategy can be the driving force to optimize this internal network. Not only is there an internal network to build but an external one that involves both the supply chain and the customer base. As one looks at the supply chain, it has become very complex with its multiple relationships, currencies, products, and processes. An understanding

of each of these aspects on a global basis will assist in driving the maximum value from the supply chain.

The CPO should review current supply relationships in order to understand how to leverage those relationships in a global economy. A supplier may be capable of expanding its business into other countries. If the customer is establishing a presence in a country or region, is it beneficial to ask the current strategic supply chain to follow the same strategy? When reviewing localization/globalization, one must consider not only the being in the specific country of the customer but also the low cost country of that region. The overall global strategy should also include a review of the effect of currencies on the organization. As the CPO reviews the supply side effect from currencies, there should be a review on the customer side, as well. The CPO and the internal sales functional leader should consider and develop a joint strategy on the neutralization of currencies. Another activity that supply management and the sales organization should work together is product selection. Innovation is usually a benefit to the customer so that they can be on the leading edge. Selection of a supplier should evaluate innovativeness as key criteria. When suppliers are selected, there also needs to be a consideration that the products or processes could become revenue generating. Once again, the strategy of the CPO could lead to additional opportunity for the organization by maximizing the supply chain value.

Industry dynamics also play an important part of the CPO strategy. This has been most evident in industries like automotive, paper, chemical, etc. Management of supply risk becomes one of the top priorities. If the supplier is located in another region, the management of risk compounds itself due to the unknowns. Will there be enough raw materials to produce the products, will the docks be too crowded or on strike, will the product quality be good, will there be enough vessels available to ship your product? These are some of the risks in which the global strategy must take into account.

**International Purchasing Office.** With all of these elements, the CPO must build a robust strategy that is aligned with the organizational strategies. One method to start the implementation of these strategies is to develop an international purchasing organization.

An International Purchasing Offices (IPO) plays a variety of roles:

- Help with local customs and local norms of doing business
- Provide ground supplier quality improvement work
- Perform prospecting activities by alerting potential suppliers in the region that the organization is interested in finding a source for that particular commodity
- Provides employees to focus on geographies to both manage project and relationships with suppliers

The focus should be on supplier development and technology searches to match divisional/business needs, which are aligned with its Commodity Team strategies. The Commodity Team ideal structure should have a procurement engineer, product engineer, tool engineer, logistics analyst, and financial analyst included in it. This provides a holistic view of the global opportunities. The overall focus of the IPO is to assess and develop capable suppliers, build strong relationships with the existing and new supplier's top management team, ensure flawless execution of projects, and implement projects and product savings with suppliers as required by the commodity teams and divisions. The expectations are that the quality stays the same or is improved, current material cost is lowered, and cost models are reduced which will increase product competitiveness. Top management support and alignment

with the organizational and customer strategies is the key to obtaining the approval to build an IPO organization and to make it integral to the sourcing process.

**Low Cost Country Strategic Sourcing Process.** The first step in developing a global sourcing strategy is to profile a sourcing group that includes understanding internal spend, total cost, specifications, external global supply marketplace, and global trends. Low cost country sourcing maybe confused with low labor cost country. One must also understand all the cost drivers so that the total cost is considered and not just one element of cost. If labor is not one of the key cost drivers and transportation is, then one will want to review sourcing very close to the point of use, wherever that may be. Specifications may have to be updated for global consideration while understanding the equivalents that may be proposed. A review of the global supply opportunities should include an understanding of the countries' policy, macroeconomics, government support, education, and regulatory issues. Global capacity and trend analysis are additional components of the first step of low cost country strategic sourcing process.

The next step of the process is commodity strategy development. With so much volatility in the market a deeper understanding of the industry dynamics is necessary. Improved analytical capabilities, financial forecasting, and scenario modeling are needed in order to capitalize on the opportunities created by the marketplace. Some strategies that could turn the volatility into a benefit are hedging and accurate timing of switching from contracts to spot buys and vice-versa. When developing a commodity strategy, a regional approach may minimize the supply risk.

Development of the supplier portfolio includes defining the criteria in which one will analyze the long list of global suppliers. Criteria, taking into consideration low cost country, include transportation, cost of quality, additional inventory while in transit, additional safety stocks, expedited shipments, warranty claims, visits to supplier, currency risks, country risks, duties, taxes, connectivity costs. Once the criteria are developed, the information is analyzed, the short list will be developed and the quoting process can begin.

The quoting process can be through a RFQ, RFP, or reverse auction depending on what route the buyer thinks he/she will obtain the most accurate responses. One could utilize the RFP process for detailed information and then the reverse auction for the negotiation stage. When requesting information from the global suppliers, the buyer will need to be very specific on lead-times, safety stock requirements, in transit volumes, transfer of ownership, currency, and market volatility requirements, assurance of supply, and quality expectations and ramifications. The total cost as stated previously are all elements that must be a part of the request. The breakdown of the costs will be beneficial when negotiating as well as being able to develop a "should cost model".

Negotiations will have uniqueness depending on the suppliers' country of origin. Chinese, for example, look at the long term and one can expect negotiations to be a very long process. Strong relationships must be built before closing a deal and this takes time. U.S. executives have a reputation for impatience, and the Chinese will drag out negotiations well beyond deadlines. On the other hand, the English are usually interested in short term results than in the long term future. Decision making is usually slower in England than in the U.S. It is advised not to rush the English to a decision. There are also cultural differences on the level of the person that should attend the meeting or whether one should be direct in discussions. These

are a few of the areas that need to be considered when building a negotiation strategy that will encompass different parts of the world.

Once negotiations are finalized and a supplier is selected, it is now time to integrate that supplier into operations. Communicating the selection of the supplier internally is extremely important to the success that supplier will have in operating with the organization. Also, the implementation or transition plan should be built with key stakeholders in the organization such as engineering, logistics, production control, inventory management, and manufacturing.

Continuous improvement of the supplier is the last step of the strategic sourcing process. Once a supplier is supplying goods or services, it is not enough to stay at status quo, the supplier should continuously look for ways to improve their business as well as their supply chain's business. An example of this is to implement lean into every operation which is a method to eliminate waste, defects, noise, and excess time. Create a value stream map to make sure that every step is valuable, capable, available, adequate, flexible, flowing, pulled, and leveled. Implementation of "Lean" is one method that a supplier can use to continuously improve its operations.

**Conclusion.** The CPO needs to understand the complexities of the supply base, the internal influences, sourcing processes and the need for a focused global organization. These are just a few of the areas, which assist in building a robust global supply chain. However, there is still risk that may not be visible. The best that an organization can do is to study what is available in the marketplace and make the most educated decisions based on the facts, industry knowledge, supply market knowledge and experience.

## REFERENCES

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