

## **Global Sourcing: The Race to Future Strategic Competitive Advantage**

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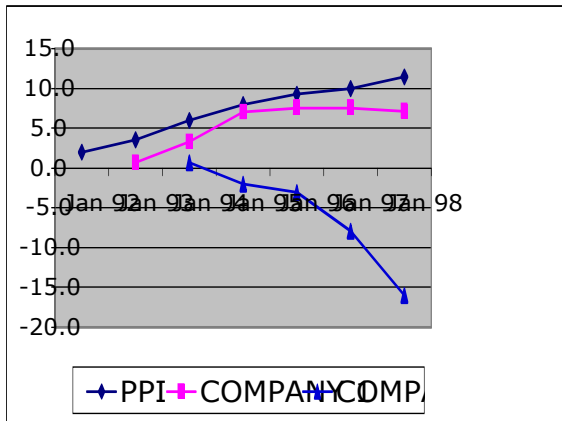
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**Abstract:** Strategic competitive advantage is about being better than your competitors in terms of the things or services that your customers or markets want from their specific global market. We believe that all markets are global. Hence, all business operations must consider both the global markets for sources of supply as well as an expanding customer base. Competitive advantages can be short lived because competitors learn to imitate it or even perform at higher standards. This presentation will show how successful companies are racing to create sustainable strategic competitive advantage through their global supply chains. We believe that achieving sustainable competitive advantage is a five-step process that can be learned and practiced effectively and efficiently. This presentation will expand these steps to identify and discuss the processes, tools and leadership needed to drive an organization to achieve sustainable strategic competitive advantages through its global supply chains.

**Introduction:** Simply put, an organizational strategic competitive advantage means being able to do a thing or things that competitors cannot readily achieve. The strength or value of the competitive advantage depends on a competitor's ability to catch up — the longer it takes the stronger the advantage. Since organizations must beat their competitors in their market place, the concept of strategic competitive advantage must always fit an organization in terms of its industry, products, service and markets. We believe that an organization cannot achieve sustainable strategic competitive advantage without appropriate strategies and processes to ensure that it's operations are better than their competitors over the long term.

The figure on the next page compares two companies from the Auto industry with the Producer's Price Index (PPI). Note that the PPI increases steadily over the time frame shown. The data for Company 1 reflect that initially its costs increased less than the PPI, but at about the same rate. In January 1996, its costs stabilized and then began to decrease in relation to the PPI. The change in direction is the result of improved cost management. The data for Company 2 show that it had a distinct competitive advantage — its costs actually went down across the entire timeframe. Its costs have decreased faster than the PPI increased.

Clearly these two companies are doing it right. But, Company 2 was doing it better and had a sustainable strategic competitive advantage that Company 1 has not yet been able to match.



If you're doing it right, it means creating strategic advantages that will endure and continue to bear fruit for years to come. These two companies learned long ago that they could create strategic competitive strengths by building relationships with suppliers based on mutual advantage rather than price alone. These relationships are the foundation for the efforts to improve quality, delivery, cost, and to root out inefficiencies. Company 2 has a sustainable strategic competitive advantage and it is

winning the head-to-head, dog-eat-dog worldwide auto industry competition. Company 1 is still close behind and working diligently to close the gap. All other competitors must bite the bullet and play catch up or disappear from the industry and market.

Michael Porter identified two primary types of strategic advantage, 1) cost advantage and 2) differentiation advantage. The cost advantage comes primarily from increased relationships between engineering, supply management and operations to create benefits from ongoing operations while the differentiation advantage comes primarily from marketing. The two companies above found that if they treat their customers, work force and suppliers with respect and work with them for the mutual advantage of all concerned, the result is real world-class competitiveness based on a sustainable strategic competitive advantage. Without strong relationships based on integrity and ethical practices, we will always fall short of any strategic bar that we set for ourselves.

**Creating sustainable strategic competitive advantage:** Creating global strategic competitive advantage through your global supply chains is a five step-process with many sub-sets, models and tools. Step one creates and supports a learning organization so that everybody learns to be world-class. We will show how strategic learning involves the global business environment and distinct analytical processes. Step two uses lean thinking and other tools/concepts to drive out waste and lower total cost while increasing productivity to become the low-cost producer. Models and tools are available to support this step. Step three develops processes and relationships to focus on quality, productivity and performance. Models and tools are also available to support this step. Step four focuses on the customer to lead the supply chain to provide products and service better than competitors. Step five provides continuity. It builds from the other steps to ensure that the sustainable strategic competitive advantages once achieved will be sustained over the long-term.

**Step 1: Creating and supporting a learning organization.** Some believe that knowledge is the ultimate competitive advantage. This may be an overstatement, but knowledge certainly is key to creating and sustaining strategic competitive advantages. As we see it, we must be able to identify what our organization needs to know in the future. Similarly, we must identify who needs to know it and when they must not only know it but also be able to use that new knowledge effectively. Knowing that our people have learned and can apply this required new knowledge is a critical factor in lean thinking and a Zero-defect culture. Moreover if this new

knowledge is to be the foundation for strategic competitive advantages we must ensure that our people know and can apply the knowledge better than our global competitors.

To make knowledge truly effective we have to leverage knowledge, what we know and what we can learn, across the organization and the supply chain. Knowledge provides extraordinary power to people and teams. Similarly, we must leverage knowledge throughout our supply chains to ensure that the elements of our supply chains that need to know and use this new knowledge also have learned it with our people and are ready to correctly employ the knowledge in their operations when needed.

We must teach effective and dynamic executive and operational leadership that can and will change organizational culture throughout the supply chains to identify, design and lead the organization to significant competitive strengths utilizing existing knowledge and tools. At the same time, we must develop and disseminate the new knowledge needed to prepare the organization for the future. Research, forecasting and trend analysis are great tools here.

**Step 2: Becoming the low-cost producer in a global market.** Creating a strategic competitive advantage by developing cost leadership in the industry is a supply chain wide process that rests on detailed in-depth training concerning “should cost” analysis and cost management. Strategic should cost analyses require the knowledge and skills to accurately ascertain what an item, product or service should actually cost. We need to work toward developing and knowing cost standards for all our operations. Knowing what our design should cost is important and essential. Equally important, these analyses should also include developing accurate should cost values for competitive products based on equally sound physical analyses. This process should include actual disassembly and cost analysis of the parts and their manufacturing or assembly processes. Strategic cost advantage based on being the low cost producer provides two keen advantages to the organization. First, that organization has gross margin advantage at any price above the breakeven point. And Knowledge of our strategic cost advantage may reduce direct competition and discourage other entries into the market.

The total cost of purchased goods used in the product for most manufacturing operations in the US range from 40 to 60 percent and some may even exceed 75 percent. Similarly, we know that for many products most of the cost of the product is in effect fixed when the design is completed and published. These costs highlight the significance of supply management, marketing, production and even appropriate suppliers working with engineering in cross-functional teams to create a design that meets customer expectations with the lowest possible designed in cost. These teams ensure excellence in innovation and potential opportunities in the supply chain as well as in cost management.

Global sourcing that often means sourcing from the low cost countries or region (LCR) is also considered a very strategic method of creating a cost advantage. But just buying from a low cost source may not ensure low total cost. Even worse, it may be an operation that competitors can easily imitate by using the same supplier. We may want to take action by contract to delay or hopefully preclude this sort of competition based on price.

Economy of scale is an old strategy to be the low-cost producer. It is based on size of the operation and market. This strategy often precludes smaller firms from creating a strategic competitive edge based on low cost. We noted earlier that the concept of scale should fit the

market and the firm. Even a small firm using the correct processes and leadership may create a sustainable strategic competitive advantage and be quite profitable in a smaller market.

**Step 3: Develop processes and relationships to focus on quality, productivity and performance.** Lean thinking or lean operations is perhaps the best process developed in the last fifty years because it captures, utilizes and rests on the ability of an organization to lead itself through a learning process fitted to its products, processes, supply base and markets to create a sustainable strategic strategy second to none that we know of now. Company 2 in the example above epitomizes this idea. Indeed, many of the concepts and tools used in lean thinking grew from research and literature concerning Company 2.

We believe that the global supply base should contribute significantly to an organization's success and any strategic competitive advantages that it may have. When we say global supply base we mean any potential supplier anywhere on earth, including the firm next door, with the capability to provide the required product(s) and services on time at the requisite quality and with the lowest total all in costs. Supplier selection and development are key tools to ensure that we are building a supply base capable of meeting organizational needs. Supplier selection requires knowledge of the global resources market and the suppliers. Our goal is to select the best possible supplier to satisfy expected organizational needs. Supplier development on the other hand, includes all those things that we can and should do to enhance suppliers' capabilities once they are on our team. This concept includes managerial assistance, joint problem solving activities, joint training and professional development opportunities, long-term programs to correct performance deficiencies and even investment support on occasion. Great suppliers are usually difficult to find and our efforts to develop specific skills and operating standards can provide loyalty and ensure sustainable strategic advantage for the supply chain. Supplier relationship management (SRM) is another tool aimed at bringing the supplier firm and organization closer together to ensure mutual benefits for both entities.

Supply chain literature includes a rapidly growing number of problem-solving tools. Many of these terms or tools are listed and defined in the new ISM Glossary of Terms that is available from the ISM Website. Similarly, other literature or training materials are available to support the acquisition of knowledge and training concerning the utilization of the tools. For example, if you go to the Google Website and enter the term "competitive advantage" you will discover about 25 million references for this strategic business concept. Earlier we mentioned cross-functional teams are key concepts to build organizational unity, cohesiveness, respect, trust and enhance communication. The teams should include customer representation along with supply management and suppliers. Finally we believe that anything we do to build interaction and value in the supply chain holds the potential to create a new sustainable competitive advantage utilizing the capabilities of the particular organizations acting in unity. Such a strategic advantage might be very difficult competitors for to imitate.

**Step 4: Customer focus to provide better products and services than our competitors.** We should always want to be identified as our customer's best supplier. This identification requires us to know our customers and their current needs, standards, expectations for service as well as their expected future needs. Knowing our customers means more than just the traditional monthly calls by the sales staff or even the annual visit from an officer of the supplier. It means that we understand how they use our product(s) or services and what we contribute to them. Customers like suppliers need sustainable strategic competitive advantage.

tages to ensure success in their operations. Knowing our customer means that we have sufficient knowledge concerning their operations and needs to anticipate the future and provide problem-solving solutions before they even anticipate or face the problem.

Meeting that level of customer knowledge requires frequent and meaningful contact and communication at all levels. At the same time it requires meaningful involvement of customer representatives on our cross-functional problem solving teams as well as providing resources to their cross-functional problem solving teams. Customer focus is a mutual benefit process. A business that truly knows its customers will at the end of its day know what it has done specifically for that customer that day. Perhaps the ultimate factor in focusing on the customer is follow-up services or responses to queries or problems. Any required or volunteered follow up should be meticulously provided on time and to the right people. Successful follow up will help ensure customer satisfaction and respect.

**Step 5: Ensuring strategic program continuity.** History is replete with examples of organizations of all kinds that have started successfully, grown rapidly, faltered, waned and disappeared. Poor leadership and the lack of vision is the root cause of all these failures. We believe that the key ingredient supporting all organizational success is dedicated, honest, open, trustworthy, and ethical leadership that creates a business environment and culture in which research, creativity or innovation, fairness, growth, change, and mutual success, satisfaction or benefit can be achieved by the customers, the people involved and the supply chains. This type of business culture would be a huge and terrifying change that many people would say are impossible for many existing organizations. Even so, the right kind of tough and dedicated leadership that can vision the needed changes, educate and develop people to understand and accomplish the changes will lead the organization to success over the longer timeframe. See Exide.com to read about an old-line company with strong leadership that changed itself into a lean and high quality culture and is currently doing very well. Similarly, one can read about Toyota, Honda, John Deere, Dell and many others that have converted themselves to create a competitive advantage that in many cases is sustainable. We believe that successful cultures can be perpetuated.

**What some organizations are doing.** One of the companies that we work with sources large quantities of hydraulic parts as major components for their end products. As part of the ongoing effort to build the competitive edge by reducing total costs, they targeted about 75 percent of the spend for hydraulics to low cost countries. Most of these parts went to India and Turkey; one of their domestic suppliers followed the company's lead and created an operation in China, helping fit into the sourcing company's strategy. Now that the supply of hydraulic parts is spread across several global suppliers the total all in cost for purchased hydraulic components is down by 26 percent. This example demonstrates two lessons. First, cost reduction represents a significant opportunity for competitive edge based on cost that will be difficult for competitors to imitate rapidly. And your domestic suppliers are often interested in competing to keep your business. We should not overlook that opportunity.

Our company also has a major sourcing program for transmission components. Originally, the spend for these components was \$4.9 MM. Supplier A provided about 90 percent of the spend while supplier B provided the balance. A kaizen event for the parts and suppliers led to a decision to analyze the components based on performance requirements and play to suppliers' "sweet spots" or core competencies to redistribute the package. Now, the original supplier A

has about 18 percent, supplier B has 23 percent and supplier C in China has 59 percent. Total demand for the components has remained steady, but the total spend is \$3.8 MM. The 22 percent cost reduction is for a large part derived from the spend with supplier C in a low cost country, however the other two domestic suppliers' costs are also lower because of the sourcing company's steering business to the suppliers' competencies. The decision to resource and reallocate this spend created a competitive challenge to competitors.

These first two examples deal with addressing component families. Looking at an entire product and its components provides even more opportunity. One company routinely forms teams to redesign its products through analyzing competitors' machines and attacking every cost in its own designs. These total and exhaustive analyses lead the company to reduce basic material costs, like steel, as well as to standardize the design of all discrete components and find low cost sources for them to boot. The total cost for components or parts such as chains, tires, wheels, cylinders, linkages, etc. are often reduced by 20 to 40 percent. In one case, as part of this effort an existing Chinese supplier found ways to quickly reduce his costs by 7 percent and pass on the savings. Global suppliers will also be competitive when challenged.

The three short examples show that significant opportunities beyond just cost reductions exist for the supply managers willing to look to the global markets. The global suppliers are interested in protecting their businesses and will compete to keep customers. At the same time they can provide the requisite quality and services. Some are even interested in higher levels of opportunity such as early supplier involvement and integration. Longer term these suppliers provide opportunities to build the supply chains into more competitive operations.

**Conclusion and recommendation.** Our one conclusion and recommendation follow: We conclude that any organization with dedicated leadership tough enough to bring about the required cultural changes described above can and will create sustainable strategic competitive advantages and thrive over the longer term.

**Recommendation.** We recommend that organizations commit to total lean operations based on training, great leadership, dedication to suppliers and the development of lean based global supply chains to create and support sustainable strategic competitive advantages.

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