Learning from leaders

An executive guide for managing risk in global sourcing

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Balancing risk and opportunity amid global uncertainty

Of all the procurement and supply chain trends – opportunities and threats – to reach the executive boardroom over the past decade, global sourcing has elevated itself to a choice place, dominating the focus of a great many conversations. What is perhaps most remarkable about global sourcing throughout this timeframe is the speed at which companies adopted their strategies to support a rapidly transforming marketplace environment. Even though global trading has been around since before the time of Marco Polo in the 1200s, the past decade has seen a period of punctuated equilibrium (for example, an extremely rapid series of transformations) for global sourcing, starting first with cost-based sourcing arbitrage, and better known as low cost country sourcing (LCCS). Labor-based cost and occasional material cost advantages often drove many initial and ongoing LCCS opportunities. Next, as the margin benefits of LCCS opportunities began to erode in many markets, organizations began to focus more on supply localization, investing more significantly in regional markets to either help ensure the availability of local material and services to access potential global customers or to further develop export supply bases in a partner-like model. Most recently, companies have begun to investigate the specific meaning of "global" in global sourcing advantage and they are often finding that past strategies and approaches no longer yield the same advantages that they once did, often for a myriad of reasons.

Still, it would make little sense to consider global sourcing if the benefits did not outweigh the risks. A number of companies believe they can achieve cost savings by sourcing goods from low-cost countries and many of those organizations also believe that global sourcing programs can achieve cost-cutting goals. However the question many companies are beginning to ask, is at what cost are the savings – or identified savings – actual coming? After all, global headlines tell the story of risk, not of savings – tainted peanut butter (both regular and organic varieties), dangerous toys, chemically-laced milk and infant formula, radioactive metals, late shipments, supplier bankruptcies and a rise in protectionist global sentiment that has already resulted in new import tariffs for certain goods in the EU and China, among other markets. Then there is the question of global sourcing savings themselves. Companies may think that they are saving 10-35 percent. However when factoring in volatile regional commodity prices, currencies, shipping costs, import duties and tariffs, taxes, trade financing and other determinants, the question of savings becomes even more nebulous. In addition, organizations predicated much of their global sourcing activity in the first place on constant, high volume orders. As order volumes have declined in the recession, many companies began looking to inventory less and access shorter lead times to help maximize working capital. Not exactly a prescription for waiting 2 to 6 weeks after payment, in many cases, for a full container to complete its journey from a supplier's facility half way around the world.

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However, rapidly falling volume is not the only factor that separated this downturn from previous ones. This past decade's global economic flattening is accelerating not only the pace of trade and activity, but also the interconnectedness of all of our activities. In the recent recession, this flattening has hastened the acute pain many organizations felt, especially those who favored quick-win and often knee-jerk reactions rather than embracing systematic approaches and best practices. Robert Rudzki, President of Graybeard Advisors and co-author of Straight to the Bottom Line puts it best when he notes "companies operate in an increasingly global and competitive market – and are now faced with growing economic uncertainty. There are too many examples of companies that have tried the 'quick and dirty' approach to cost reduction, only to find that their wins were not sustainable over time."

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Granted, it is all but impossible to wish global challenges away. However, there are ways of overcoming them and to create, in Robert Rudzki's words, "sustainable" strategies and practices. In this regard, the right enabling technology can – and should – play a much greater role in global sourcing efforts. While appropriate in all global sourcing models and contexts, technology is even more valuable amid global economic uncertainty because of the speed and flexibility with which it allows companies to react to changing market conditions (for example, declining volumes, re-sourcing, performance-related issues, etc.). In increasing number, companies across industries are turning to sourcing platforms, advanced buyer and supplier decision support tools, as well as supplier performance and supply risk management solutions, to mitigate global sourcing risks and take advantage of opportunities that present themselves.

Throughout history, leaders have often been pioneers, especially when exploring and exploiting global opportunities. However, when it comes to global sourcing today, this is no longer the case. Perhaps the best news for companies either looking to regain cost and other advantages from current global sourcing programs, or even those investigating new global options for the first time, is that there is no need to be a pioneer. Rather, it is possible to learn from what leaders are doing and how they are leveraging the right set of technologies and approaches to achieve global sourcing results.

Sourcing is complicated – global sourcing even more so

Virtually everyone in a procurement organization – from recent college graduates working as analysts through to the most senior chief procurement officers – knows that sourcing decisions are complicated. Attempting to quantify and measure unit cost, total cost, value and risk at all stages of a relationship, starting with negotiation and throughout managing a supplier lifecycle, involves both art and science. However, if most sourcing is complicated, global sourcing is even more so. And where there is complexity – especially complexity that is difficult to measure – there is risk. Unfortunately, one of the largest risks of all is that companies tend to gloss over many of the added risks in the global sourcing process – neglect that can lead to eroded savings, higher costs and worse. While it would be possible to fill a small book with all of the cost and risk factors global sourcing introduces, the following provides a short-list that covers many of the basics:

Practically anytime there is a complex decision, companies inevitably find ways to adapt their evaluation model to account for different elements. Organizational and technology tactics for this include multiple bidding approaches (for example, bidding in rounds, weighting, scoring, etc.) or optimization to do trade-off and 'what-if' scenario analyses. However, managing added complexity requires more than a single axis of focus. It also requires that organizations support approaches to simplify the global supplier enablement and management process (training, education, information gathering, etc.) and maximize the amount of feedback they provide to suppliers in the sourcing and negotiation process. In an offline or Excel driven model, complexity can quickly get in the way of these efforts.

Fortunately, the right set of enablement technologies can help organizations accomplish their goals in this regard such as:

- Factoring into account basic supplier-suggested options to reduce total cost (for example, transportation options, order quantity, etc.).

- Factoring into account more advanced supplier-suggestion options to reduce total cost (for example, materials substitution, index pricing, pre-payment).
- Streamlining the supplier qualification and performance management processes. Since a single global or regional standard for most certifications does not exist (for example, ISO 9001, TS, etc.), companies must automate their approach to gather and analyze significant amounts of supplier-provided information through online survey and analysis tools and proactive performance management capabilities. If they rely simply on supplier-provided certifications (which are often "for sale" in China and other market segments), they could potentially expose themselves to significant risk.
- Meeting large-scale sourcing needs for projects that require managing a global supply base across millions of items and SKUs and dozens of potential geographies.

Global sourcing risk and cost factors

- **Currency** – Companies base their global sourcing decisions and negotiations in either local currencies or their own. In either case, a currency can move against an initial decision, creating immediate higher costs or causing a supplier to force a renegotiation.
- **Inventory risk** – Global sourcing requires global transportation. This requires either that an organization take on additional buffer inventory on the domestic front or that a supplier manages a domestic warehouse facility, owning the inventory and delivering parts in a just-in-time (JIT) and/or vendor managed inventory (VMI) model. Under the former option, companies must increase their working capital requirements to hold additional inventory. Further, global sourcing often requires different payment terms before goods actual ship.
- **Trade** – Most organizations fail to coordinate efforts between procurement, operations and customs teams. The tax, tariff, customs, duties and related costs of global sourcing activities are highly variable and can rapidly change over time based on world trade trends and national (plus global) politics.
- **Transportation, logistics and warehousing** – Global transportation costs are, perhaps, the largest added cost for global sourcing projects. Even though these costs are currently low relative to their 2008 highs, they still often form a material (low double digit) percentage of the total costs involved in global sourcing activities.
- **Commodity prices** – Companies often falsely assume that commodity prices for raw materials and semi-finished products (for example, copper, aluminum, resin) follow a single world price. Nothing could be further from the total cost truth. Local pricing for commodities can offer significant variation and is often higher in "low cost" markets.
- **Supplier habits and cultural acceptability** – Just as there are not world standards for commodity pricing; there are not world standards for ethics and behavior. Recent global sourcing scandals in the headlines include tainted products, child labor and poor working conditions. These point to a few of the challenges, but in many cases, supplier habits and cultural acceptability problems can manifest themselves in more incremental ways such as quality and overall performance, especially when companies fail to aggressively manage and develop their global suppliers. In doing business with truly low cost suppliers, who often make up margin points by cutting corners, these factors become even more of an issue.
- **Global uncertainty** – The recession highlighted additional cost elements of working with global suppliers. These include helping suppliers secure access to capital/credit and proactively monitoring supplier stability and financial viability on a global basis to help ensure continuity of supply (and to create enough lead to invest in supplier development initiatives and investments or change suppliers if necessary).

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Getting to total cost

The fundamental goal of any supply management organization sourcing on a global basis should be to arrive at total cost results that match or exceed their expectations and estimates going into such an effort. In other words, an organization should make sure that a 20 percent savings opportunity becomes a 20 percent savings. Just as there is no reward for second place in a coin toss, there is no benefit to identifying saving opportunities only to see them go unimplemented. Organizations involved in a range of global sourcing efforts – from custom engineered materials and parts to complex services – are quickly coming to realize that the right technology platform can be invaluable in helping them arrive at the optimal total cost option(s) and to maintain savings once they identify and implement opportunities. They have observed that traditional ways of calculating and managing total cost (for example, Microsoft® Excel, e-sourcing and reverse auctions, global trade platforms, etc.) are useful, but are insufficient alone, falling short of the level of accuracy that companies need.

Indeed, companies must begin to factor in additional areas, identifying tools that help enable them to go beyond material costs and basic logistics components of cost build-ups. Organizations need a level of depth that allows them to consider, for example, raw material cost and yield on a global basis. On the logistics side, companies must look at duties, hub costs, and complete transportation costs. It is also critical to identify ways to bring outside information into these types of calculations on a regular basis. When it comes to achieving savings or avoiding incremental costs, procurement teams are beginning to understand that currency of information is all the more critical when it comes to managing global sourcing activities. This type of data might include, for example, local pricing indices for energy or metals. Technology platforms should help global sourcing teams to organize and incorporate this information into total cost pricing formulas.

When it comes to managing total cost on a global basis, supply management platforms should enable a range of capabilities such as total cost modeling, flexible bidding, scenario modeling for sourcing awards as well as a global program management cockpit to track and measure projects and estimated savings. With these capabilities, companies can begin to automate how they measure and account for the cost of inferior supplier performance and risk as well as the cost of contract variance to help facilitate compliance. Platforms that enable this capability also enable a new level of executive visibility by allowing summary reporting and analysis drill-down. However organizations should not just look at these capabilities from a feature and function perspective. They should look at the types of improvement that they make possible to the business. For example, they can help enable executives to begin to ask questions about how much they have saved – and how those savings were achieved.

Many organizations today – even those with a long track record of global sourcing – do not have a single database or system of record that enables them to track the progress of projects and to report on the status of current work streams. Global supply management technology platforms can enable such a new system of project record while also enabling organizations to quantify opportunities and to then apply estimated or actual savings across an entire program to roll-up this savings across specific categories. They also enable better planning based on past experience, allowing organizations, as an example, to roll-up the past results of their auctions and to see if they are more effective than an RFx or optimization in a given model (or, perhaps, if a combination of negotiation approaches delivers a better result for a category or geography).

Achieving global sourcing visibility – select questions that platforms should address

- What is my target savings for multiple years – first, second, third, etc.?
- What are the objectives for this program and how is our performance tracking?
- Where do we stand today – how is our progress against stated targets?
- What is the impact of our efforts – across divisions, categories, events, projects, etc.?

Global sourcing – managing supplier risk

While it is easier to think, contemplate and relate to the impact of a recession when it hits close to home (for example, Detroit, MI or Manchester, UK), perhaps those that have the most to lose in the downturn reside in global or developing markets. Procurement leaders should look at forecasts of potential loss of world-wide manufacturing as further proof that in today's market, global sourcing strategies that focus exclusively on emphasizing a low-price outcome can lead to higher costs in the future.

Without question, sourcing professionals should focus on driving down prices, but they should do so with a focus on not harming the prospects of their suppliers. This can help them to avoid making the wrong decisions during the hazardous market conditions that confront us every day. However, at the same time, companies should look to expand their definition of supply risk beyond the basics."Will my supplier be in business in 6 months?" is an essential question to consider as part of a sourcing effort. At the same time; however, procurement should also consider what types of other risk factors (for example, product quality, product safety, etc.) their suppliers might introduce. Organizations that excel at global sourcing make a large contribution to their company's bottom and top lines by introducing plans that enable them to identify and mitigate a range of vendor and procurement risks. They accomplish this by aligning supply market strategies and supplier selection with company objectives, establishing consistent supplier insight and standardizing their approach to measurement and process.

Fortunately, blueprints for global supply risk reduction models already exist and many contain similar components. These include the ability to:
(1) monitor overall supply risk,
(2) conduct supplier assessments and audits,
(3) control and orchestrate supplier development processes and
(4) manage overall internal and external supplier collaboration elements.

The first of these elements, monitoring overall global supply risk, requires that organizations deploy an automated process (and supporting technology) that enables a balanced scorecard approach to measuring performance, trend analysis, proactive alerts and formulas and also the ability to roll-up scorecards across functions, stakeholders, and relevant supplier factors (for example, sites, geographies, ship-to locations, etc.). When it comes to supplier assessments and audits, companies should take an approach that complements the financial and quantitative side of supply risk monitoring by also focusing on qualitative interviews and information gathering, rolling up and aggregating responses and results. At a minimum, organizations that succeed at global supplier development often rely on platforms that enable the management of milestones and goals, provide a virtual team or workspace environment and allow team members to link specific tasks or projects with broader elements of the supplier management process (for example, scores, surveys, etc.) As a last blueprint element, collaboration tools facilitate a countless number of interactions (with both internal stakeholders and potentially multiple tiers of suppliers) through interaction-focused portals, peer analysis and by capturing supplier feedback and input.

Global sourcing – learning from leaders

What separates top performing companies from the rest of the pack, when it comes to global sourcing? Leading organizations – regardless of industry or geographical sourcing focus – react flexibly to changes in all economic environments and use technology to create on-the-ground leverage and support in geographies across the world. Take the case of one high tech manufacturer that uses total cost breakdowns for material costs, supplier costs, supplier profit, duty, warehousing and transportation to understand not only total cost, but relative supplier profitability and risk as well. Or take the case of a manufacturer that uses a global sourcing technology platform to collect information across thousands of lanes and hundreds of suppliers to help optimize in-bound logistics costs. This company collects a variety of supplier-submitted data including price per mile, minimum charges, duties, and surcharges. For both of these organizations, arriving at a practical means of collecting and organizing the hundreds of thousands of data points submitted by suppliers and also aggregated internally is the first step toward pragmatic decision-making and ongoing global supply monitoring. With this information in hand, it then becomes possible to turn to the analytical power of a global sourcing platform – the area where technology can often pay the biggest dividends providing the underlying information is accurate and bounded. Sourcing optimization tools can then help companies understand the impact of different award scenarios and can also enable further discussion and negotiation with suppliers based on an evolving set of award criterion which would have been impossible to discern at the start of a project.

By putting in place the right technology platform and processes today, companies can help drive additional savings while reducing their overall risk exposure and solidify a foundation for future growth and global expansion as the global economy rebounds.

In other cases, global sourcing platforms can help companies to incorporate third party data collected outside of the negotiation inside. One consumer food products company uses their supply management technology platform to automatically incorporate local index-based prices that often change on a daily basis. This allows them to track how changes in index prices can lead to total cost variation on a regional basis while providing full visibility and transparency into total cost – on a supplier-by-supplier basis. Not only does this help reduce risk and provide a means and basis to potentially forward buy, hedge or lock material costs – it helps enable suppliers to sharpen their proverbial bidding pencils as well, allowing them to provide price quotations based on their actual costs in addition to local commodity pricing on a regional level using local index prices. This company is not alone in its efforts. A number of organizations in the Consumer Product Group (CPG) arena are beginning to take a similar approach to regional pricing data for packaging, using local linerboard index prices to model total cost. These examples suggest that leaders start by putting in place the right global sourcing team, a group that can go beyond a basic understanding of cost to understand and account for regional differences, cultural variations, supply risk, and total cost in the sourcing decisions and supplier management activities. Equally as important, these organizations also realize the need to introduce the right platform to automate the global sourcing and supplier management process – not just specific elements (for example, transportation sourcing) or negotiations. This allows leaders to not only focus on data analysis, but also data capture and synthesis across their global sourcing efforts, keeping their eye on the landed cost prize by relentlessly focusing on total cost at both the point of negotiation and on a continuous basis once they establish and implement a relationship. Not only do these efforts help enable leaders to drive global sourcing savings in uncertain global economic environments – they also provide them with speed and flexibility to meet and exceed business expectations. By putting in place the right technology platform and processes today, companies can help drive additional savings while reducing their overall risk exposure and solidify a foundation for future growth and global expansion as the global economy rebounds.

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