

## China Sourcing: Are You Ready?

### Key Finding

More than 60% of manufacturers are now sourcing from China as part of their low-cost country sourcing strategies. The frequency and volume of China sourcing will only increase over the next three years, and such moves will increase the importance and value of procurement operations. However, unless it's managed properly, China sourcing can result in a myriad of hidden costs, supply disruptions, and intellectual property risks.

### Research Results and Recommendations

Enterprises in all industries are aggressively adopting low-cost country sourcing (LCCS) strategies as a way to drive the next wave of supply savings and to penetrate new markets. Within LCCS, China stands out as the low-cost supply market where procurement executives see the most potential benefit. Evidence findings from two recent Aberdeen studies indicate that:

- More than 85% of chief procurement officers rated LCCS among their organizations' top three strategies for the next three years. And more than 60% of these executives said their organizations are currently sourcing from China. ([The CPO's Agenda](#), March 2005)
- Seventy-eight percent of supply chain executives responding to a recent Aberdeen research study reported that their companies are currently buying or selling (or both) in the China marketplace. ([New Strategies for Global Trade Management](#), March 2005)

### Complete Findings

Learn more about LCCS strategies by reading:

√ [The CPO's Agenda](#)

To participate in Aberdeen's Best Practices in Low-Cost Country Sourcing study, send us an e-mail at: [supplyresearch@aberdeen.com](mailto:supplyresearch@aberdeen.com)

Those figures are up from just two years ago, when 64% of companies reported doing business in the Asia-Pacific region. ([The Global Sourcing Benchmark Report](#), June 2003)

The attraction to China is obvious: Chinese suppliers can manufacture goods at prices 30% to 50% lower than in the U.S. Locating supply or manufacturing in China also can reduce inventory and shipping costs and cycles, and improve service to customers in nearby emerging markets. China itself offers the most compelling developing market of about 1.4 billion people.

A well planned strategy for sourcing in China is a major step toward reaping the benefits of LCCS, but enterprises must be careful to devise strategies that can overcome the significant and potentially costly challenges of sourcing from China.

### Challenges to China Sourcing

To be successful, procurement organizations need to understand three key challenges when sourcing from China:

- *Identifying and Assessing Suppliers* – Pressed to further reduce supply and delivery costs while helping their companies penetrate new markets, procurement executives are developing strategies and procedures to identify, assess, and manage low-cost country suppliers. Nearly three-quarters of procurement executives rate the identification of foreign suppliers as one of their leading challenges to effective LCCS. Supply managers found it very difficult to identify new sources in emerging, low-cost countries — such as China — where their companies have not yet conducted business and where little intelligence exists on supplier capabilities, constraints and financial viability.
- *Mitigating Risk* – The risks in a China strategy range from supplier continuity and quality to intellectual property protection and supplier on-boarding (i.e., implementing new offshore suppliers). Changing tariffs, rising energy and material costs, terrorist threats, outsourcing, transportation and logistics costs and uncertainty, and unforeseen delays have elevated the importance of assessing and managing supply risk. Supply managers must also mitigate supply constraints, longer lead times, and increases in supplier bankruptcy and financial instability.
- *Getting to Know China* – Despite reaping the potential cost savings of 30% to 50% over U.S.-manufactured goods, other factors affect the total cost and value of Chinese sources, notably differences in basic language, culture, and time zones, along with currency fluctuations and geopolitical unrest that can influence China’s stability as a source for procured goods. Example: Ingersoll-Rand estimates that transportation, duties, taxes and other cross-border logistics costs range from 13% to 24% of the basic price of imported materials and parts. Enterprises will look to third-party information services for assistance in ensuring accurate landed cost calculations.

## China Sourcing Success Strategies

Capitalizing on the potential benefit of Chinese sources requires supply management groups to balance trade-offs of performance, risks and cost-savings opportunities. Aberdeen research found that leading enterprises deploy the following strategies:

- *Accessing supplier intelligence services.* Nearly 70% of procurement executives will rely on external information sources and service providers to provide the intelligence required to identify and assess supplier capabilities, constraints, and financial viability capabilities.
- *Automating sourcing and procurement processes.* Procurement execs view adoption of sourcing and procurement automation as a major enabling component of their LCCS strategies, helping speed data acquisition, communication, and supplier assessment. In fact, e-sourcing users report that online tools have increased and improved negotiations with offshore suppliers<sup>1</sup>. Overall, more than 80% of respondents from small and mid-size firms view automation as key to their LCCS plans. For smaller firms, limited resources will mandate increased reliance on automation and outside services.
- *Accessing intelligence on tariffs, trade rules and landed costs.* Material and manufacturing savings can be quickly undone if a company doesn’t fully understand the transportation, handling, and tariff costs associated with moving the acquired product to its manufacturing site or end market. Calculating total landed costs requires understanding constantly shifting harmonized system (HS) code, tariffs, transportation, drayage and handling costs, as well as cross-border regulations. Example: Retailer Saks, Inc. tapped its e-sourcing provider to develop functionality extensions and information links to access timely tariff and trade information and accurately calculate total landed costs.

<sup>1</sup> Aberdeen Group’s E-sourcing Index (ESI). See AberdeenAccess at [www.aberdeen.com](http://www.aberdeen.com)

- *Establishing an international purchasing office (IPO) in China.* The biggest LCCS lesson is that it is difficult – if not impossible – to effectively manage supply from the other side of the globe. To be successful, enterprises must devise strategies for developing or outsourcing supplier assessment, development and management duties. Larger enterprises and manufacturers are more inclined to set up their own IPOs because these firms have the spend volumes and resources to justify such an investment. Larger firms are also more likely to hire regional supply market experts on staff. By comparison, more than half of mid-size firms use or plan to use external service providers for in-country support for supplier assessment and management.

### LCCS as a Revenue Driver

In *The CPO's Agenda*, Aberdeen found that procurement organizations are employing strategies to help their companies penetrate new markets. More than three-quarters of procurement executives report their supply management organizations are playing some role in their companies' expansion into new markets, with 20% saying procurement plays a leading role. Similarly, nearly 70% of procurement executives cite a role in predicting customer demand, with 20% saying their organizations play lead roles.

One example: Schneider Electric North America (SENA), resourced more than 60% of its spend to capitalize on low-cost country sources and eliminate supply chain-related costs (e.g., logistics and inventory) by adopting sources closer to manufacturing sites and end markets. SENA established international sourcing teams comprised of procurement, engineering, manufacturing, sales, marketing and human resources. Each team is focused on costing and sourcing specific commodities within low-cost markets. The division set up IPOs in such countries as China, to assess, develop, and manage local supply and to advise the international sourcing teams. The strategy lowered supply costs and helped increase sales to emerging markets, such as China.

### Aberdeen Conclusions

China is fast becoming a proxy for low-cost-country sourcing. Procurement executives in all industries are being forced to answer: "What's Your China Strategy?" Aberdeen research finds that the siren song of the benefits of China sourcing – and LCCS in general – can leave the unprepared marooned with unforeseen costs and risks hidden beneath the surface. Avoiding such problems requires a balanced sourcing strategy that examines total supply costs, performance, and risks.

Aberdeen is currently examining the attributes of LCCS in its Best Practices in Low Cost Country Sourcing (LCCS) study. If you believe your company is executing a superior LCCS strategy, we would love to hear from you. To participate, contact us at: [supplyresearch@aberdeen.com](mailto:supplyresearch@aberdeen.com).

### Related Research

[The CPO's Agenda](#); March 2005

*New Strategies for Global Trade Management*; March 2005

[The New Value Equation for Supply Management](#); January 2005

[The Global Sourcing Benchmark Report](#); June 2003

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