

Global Sourcing Operations: How and Why?

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Abstract. The expansion of world trade and world prosperity is an unending responsibility for business and government leaders. The acquisition of materials, parts or components, services and capital equipment is all part of world trade. Supply managers have a dual responsibility to society, and these vital roles include significant conflicting responsibilities. First, we are responsible to protect our organizations in terms of quality, total cost, availability of materials and second we must support the growth of trade. Strong forces worldwide make it impossible for an organization to sustain a policy of ignoring global resources. Like it or not, we all work in a one-world economy.

Introduction. This paper aims to help supply managers logically define why and how to use global sources. Supply managers must know why, how, and when along with the processes to create and utilize good sources in a global supply chain. At the same time it will help us understand the obstacles and barriers to using global sources. Finally, our intent is to help supply managers understand the benefits gained from global sourcing and lead the organization to successful global operations.

Practical Reasons for Using Global Sources. Research and conversations with professionals identify many reasons for using global sources. Our list of reasons for identifying and using global sources all respond to strategically important competitive issues faced by nearly every organization today. In 1998, CAPS as part of a major joint study to create a five-and-ten year forecast for the purchasing profession cited global supplier development as one of 18 critical issues for the future. It is our opinion that these reasons will make global suppliers even more important in the future.

1. Total all in cost including transportation, insurance and duties
2. To meet quality requirements
3. Material is available only from global sources
4. Technology is only available from global sources
5. To establish additional sources or build competition
6. Anticipated or actual material shortages
7. Competitors have or are going to global sources
8. Support for other global operations or global markets for domestic products
9. Global sources are more reliable
10. Joint ventures

Our efforts to reduce supply chain costs drive us to look for solutions from changed processes in the supply chain. Supply managers in a medium sized electronics company making a high-tech specialty product faced increasing costs from an intransigent wholesaler that imported a specialized part for them from Europe. The supply manager learned that his company's European sales office was located very close to the European supplier. After considerable thought the company arranged for its sales office to act as an IPO. The order goes directly from purchasing to the IPO to the supplier. The European supplier shipped directly to the company. Service levels were maintained and total cost was reduced by 50 percent.

Similarly, actual or anticipated shortages are often the reason for looking to global suppliers. A food processor had sourced fresh garlic from California where the going price was \$1.50 per pound. A prolonged drought first curtailed and then stopped supplies from California. The processor discovered excellent sources of raw garlic in China and other countries. A Chinese firm became the supplier and the market price dropped to \$.72 per pound.

The cultural component of nationalism in many countries has led to laws controlling or limiting foreign ownership in most productive processes. This forces global operators to create joint ventures in the country to employ in-country resources and benefit from investment and ownership. Joint ventures provide benefits both to the company that wants a source of supply to export and products to sell in that global market.

Understanding These Reasons in Your Organization. Supply managers must analyze the current and anticipated operational situation to analyze and select the reason or reasons for going global. This analysis must provide answers for these questions.

1. What are the attitudes of managers and others toward utilizing global sources and operations?
2. What others in your industry are doing globally?
3. Do we understand the criteria for identifying, evaluating and selecting potential global suppliers?
4. Do we have an information process and management system to support global operations?
5. What organizational steps are needed to prepare for and execute global operations?
6. Is the existing staff appropriately trained and experienced to conduct global operations? If not, can training programs to support the new program schedule be provided?
7. What are the expected benefits?
8. Specifically, what must we achieve to earn those benefits?
9. What metrics will be used to measure organizational progress toward those benefits?

Building a Global Sourcing Process. Organizations must create the buying structure and information system to support the buyers. The chart on the next page shows that the structure and information systems can range from a simple system of an existing buyer without global knowledge or information contacting an existing broker or agent to acquire materials globally to a very complex system of third-country nationals with decentralized files and information systems acquiring the needed materials to meet operations schedules in accordance with company plans and strategies. Selection, design and operation of the structure and information system depend on the business plan, company strategy, sophistication of the suppliers and supply chain, material types and requirements, managerial willingness to decentralize

<u>METHODS</u>	<u>INFORMATION SYSTEMS</u>
Brokers or Agents →	No Information, Rely on Buyer's Knowledge of Brokers or Agents
Buy From Home Office →	Keep Files on Global Sources
Buy by US Personnel Traveling Abroad →	Extensive Files and Policies to Guide Buyers
Buy by US Personnel Stationed Abroad →	Build and Maintain Extensive Files Abroad as Needed to Guide Buyers
Buy by Third-Party Nationals Stationed Abroad →	Build and Maintain Extensive Decentralized Files and Policies to Guide Multilingual Buyers

operational control, levels of information and support available in the source markets, skills and knowledge levels as well as level of training for existing personnel, content and capacity of existing information systems and managerial policies toward employing people outside the homeland as well as utilization of third-country nationals. By enhancing its information systems and levels of

employee training, a company can literally employ two or more of these methods at the same time to fit its needs in different global markets.

From the perspective of people, a company can employ one of three strategies or in more complex operations even a combination of the strategies. From simple to complex the strategies are 1) the use of brokers 2) extending our existing personnel into global operations to include employing new people with requisite skills and knowledge, and 3) building a International Purchasing Office. In very complex organizational structures the three strategies could be used in any combination to address specific needs.

Barriers to Using Global Sources. Just as every business opportunity comes with obstacles of barriers, going global for sourcing opportunities also has barriers. This figure identifies ten barriers that must be recognized and solved.

Fortunately none are insurmountable. Unfortunately none are ever completely solvable either. Of these ten barriers, the lack of managerial support is the most critical. Without sufficient senior level managerial support the global sourcing project is doomed to sniping, second-guessing and insufficient resources. Time and distance is the only barrier that is a function of the country or global markets selected. It only measures where the supplier is and how long that it takes to go or come from there. Time and distance are facts to be reckoned with and directly impact costs. The other

Lack of Managerial Support
Resistance to Change
Cultural Impacts
Time and Distance
Extension of Control
Risk Management
Access to Information
Our Own Biases
Internal Culture and Politics
Need for Training and Development

barriers are all more subjective and humanized. Much of the impact of these barriers will come from unexpected people or places. Culture drives much of this behavior. Many people resist decentralization of control because it seems to threaten their position or authority. Similarly, sharing information even internally is seen as a loss of power. Finally, risk management is a subjective process and it becomes even more difficult as we extend the process globally to include additional suppliers with different cultures and subject ourselves at least partially to the laws and processes of those cultures. Hence, it is imperative that training is provided to help employees and others adapt and adjust.

Building and Training the Staff. With the exception of time and distance, training programs and materials are available to help employees and others become culturally adept and understand the need for organizational change. One just has to learn to handle that airplane seat, food, noise and bathrooms, everything else we can study and learn. All new knowledge is important. Our training programs ought to address three things. First, how will the global operations impact the supply management processes. Everything changes, new information sources, supplier identification and selection processes change, negotiations processes change and our ability to communicate and understand the supplier becomes even more important. Similarly, supplier management processes will change. The people involved must understand these new skills and knowledge requirements and learn to satisfy them. Equally important we must understand foreign currency operations and the new payment processes. The kinds of risk involved are similar to domestic operations, but significantly more important due to the impact of other cultures, laws, distance, and communication difficulties. We global traders even have our own global language called the INCOTERMS that we must learn, understand and use. Even though people around the world have become more adept at managing cultural impact on business, it is still vitally important that we understand the other cultures impacting our operations. Our global counterparts all want to know that we care enough to learn and appreciate something about their culture.

Fortunately, we have a world of information, training systems, programs and support systems available for our use. Information is available from the Chamber of Commerce, State and Federal government and in many cases both levels of government provide sound training resources. ISM and the other professional organizations supporting supply management have sound training programs and materials to support our efforts. In some cases these professional organizations have operations and members in the other countries. Knowing that fact could be helpful in your operations with global suppliers. For example, the Global Group of ISM exists to provide resources and training for those involved in global sourcing operations.

Cultural Impacts. Culture is man's most complex invention. It has evolved since the dawn of time and will always be the driving force for our different societies. For the most part it evolves very slowly overtime. Even so, it can be changed rather rapidly by discovery, political revolution huge natural catastrophes. For example, in our time think of the opening of Eastern Europe, Russia, India or historically consider the impact of the plague in the Middle Ages or the age of the major discovers led by Columbus and others. Everybody but Columbus knew that the world was flat. He and his ninety sailors on three-leaky ships proved that the world was round in just a few months. Can you just imagine the chagrin of the European intellectuals standing with their pink tippy-toes in the water expecting to see Columbus fall off the edge of the earth?

Every society has a culture and they all are different. Even so, all cultures have the components shown here. Although, this looks relatively simple, each component and their interactions are extremely complex. Look at the US, the north is different from the south, and the west is different from the east. Similarly, we have cultural differences inside our 50 states and even in our cities. These same conditions exist in other countries. China for example has an official language, but it also has many dialects. Many people, even Chinese nationals have trouble operating

Components of Culture

- Values and Attitudes
- Religion
- Language
- The Law
- Education
- Politics
- Technology and Materials
- Social Organization

across those dialects. In the US, we have that same phenomena with our dialects and drawls.

Holidays are part of culture and many parts of the worlds have more, longer and different holidays than we enjoy. This difference in timing of holidays can cause stock outs, shipment delays or increased carrying costs. Planning and cooperation with the supplier can alleviate these impacts. A food specialty products seller simplified its supply chain to China for candles for birthday cakes. This action led to great service, but interestingly enough it also led to problems concerning the Chinese New Year and other holidays that tend to fall during the busy season for candles. To avoid stock outs required larger than ordinary inventories for the period. But the Chinese supplier smoothed out the increased inventory costs with extended payment terms. The action provided major cost reductions of about \$50,000 per container,

What saves the day for global traders is that we do not have to know it all. Rather, we must understand enough to make operations function and we must demonstrate a growing interest and knowledge of the supplier's culture. Equally important is that we have the information required to avoid the basic social mistakes. You can learn those things quickly and easily. For example, giving and receiving the calling card is a ceremony in some places. Know how to do it, have your card in both languages and give it to your counterpart with correct language up. Make sure that the translations are correct. Inspect and store the card carefully. Body language is very important to some people. Food is important and it is important to enjoy it. If its cooked you can eat it and act like you enjoy it. The important thought to this cultural process is that our mission as supply managers is to support our company operations in the best possible way and it would be a shame to let a simple cultural mistake interfere with your responsibilities. When in doubt study or even ask your counterpart to explain the situation. They usually appreciate that demonstration of interest and willingness to learn. You can and should become culturally adept as you operate globally.

Managing Currency Rates and Payments. It is a fact that during most trading periods the value of the freely exchanged currencies involved may increase, decrease or remain stable. Exchange rates fluctuate for many reasons, but the principal reasons are; 1) interest rates and the level of the money supply in both countries and to a lesser extent other countries involved, 2) government policies affecting money and the markets, and 3) demand for trade and the balance of payments. These conditions exist in all markets. Hence wise traders will take precautionary steps to protect themselves.

Three strategies exist to manage the fluctuation of currencies during the trading period; 1) put all the risk on the supplier, 2) take all the risk your self, or 3) negotiate a shared risk position between buyer and seller. Companies that hold large accounts of the local currency may elect to pay with those funds. This simplified action injures one or the other party if the rates have fluctuated during the contract.

Basically, two methods exist to remove the risk and both require use of the appropriate financial markets. First and most common is the "Hedge." If we buy a hedge for the value of the contract over a given time period, we have fixed the cost today. If we buy an "Option", we have bought the right to fix the cost of contract on a date certain in the future. Either way we have eliminated the risk and we are out the cost of the services purchased from the financial markets. It is our position that only a fool on either side would accept all the risk themselves. Certainly if we apply the concepts of supply chain management, supplier relations, respect and collaboration, we

ought not to be trying to beat our supplier out of a few percentage points of profit by making them accept the risk. Similarly, the supplier ought not to take that historic attitude toward us. Buyers and sellers should attempt to balance out and share the benefits from the movement currencies. This requires careful negotiations, establishment of metrics and break points for the adjustment of price of the product or services involved. This process is similar to negotiating escalation clauses.

Operational Benefits from Global Sourcing. Since the dawn of time people have traded between countries with the intent of sharing operation benefits in the societies involved. Many people promote protectionism, but the world is better with trade. By that we mean, we share more things and the worldwide standard of living is increased. Today, world markets are inextricably tied together and any interruptions cause shortages, price increases, loss of productivity and waste. The dock strikes on the US west coast in 2002 caused immediate and long-term impact for the American economy and our global suppliers.

Trade promotes economic specialization. Each country as well as each firm gets to do what it does best. Similarly trade promotes better utilization of resources and productivity increase leading to reduced total costs. With the exception of luxury items, we always expect trade to lead to reduced costs. Trade usually drives up quality. The great influx of the Japanese automakers and their cars into the US Market in the 80s and 90s forced up quality, increased productivity and lowered the total cost for automobiles. Finally trade increases employment and the standards of living in the trading partners and the world.

Conclusions and Recommendations. These conclusions and recommendations summarize this paper and the presentation.

1. Worldwide trade will increase and supply managers should lead that improvement by identifying and using global sources.
2. We need to be better at trade and we should increase training to accomplish that.
3. Global sourcing has many barriers, but we can train and learn to resolve those barriers.
4. Improved Logistics and communication systems utilizing the better airplanes, better ships better ports and greatly enhanced information systems using the computer and the worldwide web are much better and we can increase global competitive operations.
5. State, Federal and even International trade resources are widely available and we should use them to improve our trading operations.

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