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The Differences Count in Global Sourcing

By Philip Toy and David Mihok

Global sourcing has become a way of life for retailers, manufacturers, and other industries, as in many cases it offers a significant competitive advantage: New sources provide a greater variety of products, components, technology, and even repair and service options at competitive costs. But too many companies still treat global sourcing as simply an extension of their standard local sourcing and supply chain processes—often with disappointing (and sometimes disastrous) results. Logistics problems interrupt the flow of goods, with no contingency plans in place. Offshore suppliers run into operational issues and the buyer has no resources to either help the supplier or switch to an alternate. And the future is likely to be even more challenging, as an increasingly broader array of goods flow from emerging markets.

Recent Mercer research with large retailers has shown that companies that source globally—as well as the transportation/logistics providers that support them—can reduce costs and increase the efficiency of the sourcing process by focusing in on the unique challenges inherent in international business. On the retailer/buyer side, this means a tougher process for supplier selection and tighter ongoing management; on the transportation/logistics side, opportunities exist to tailor supply chain solutions that fit the realities of emerging markets and changing retailer needs.

The Global Sourcing Process

Obviously, global sourcing offers advantages. The cost per hour for labor in countries such as China, India, and Brazil is far less than in the US, Europe, or even Mexico. And many developing countries have greatly improved their manufacturing capabilities, infrastructure, and technical and business skills; newer plants in the Far East, for example, are often equipped with top-notch technology. Equally, more stable political climates, more reliable communications and logistics, and falling trade barriers have made it easier than ever to source from many areas of the world.

On the flip side, “going global” means that other issues take on more significance. Transportation time and costs are impacted by distance and geography. Keeping tabs on overseas suppliers may require hiring or retraining people with new skill sets or developing a local presence. Lead times, demand variability, productivity, quality, tracking, performance measurement, problem resolution—all these issues become more complex as a function of distance.

Exhibit 1 lists the five key global sourcing steps for retailers/manufacturers and what Mercer considers to be the best practices critical to implementing international sourcing initiatives. These factors, as discussed in more detail below, fall into two categories: spending more time up front on the selection and negotiation of long-distance supplier relationships, and developing a strategy that specifically deals with the added complexities of implementation and ongoing management.

Exhibit 1 Key Global Sourcing Steps and Success Factors

Key Global Sourcing Steps



Making a Match

Strategic global sourcing starts with identifying high-performing, cost-effective suppliers—a process that can be difficult to do from one’s “home” country. As is the case with domestic suppliers, a company can develop standardized profiles to compare suppliers on an “apples-to-apples” basis, and then short list the most attractive candidates for further validation. But while the due diligence process may be similar, in the case of emerging markets, much of the data required may not be readily or publicly available—making it essential to have access to local research capabilities and knowledge to ensure suppliers are rigorously vetted. Local market analyses, customer/supplier references, and site assessments can be used to get a sense of whether suppliers can deliver in terms of operational, technical, and management capabilities.

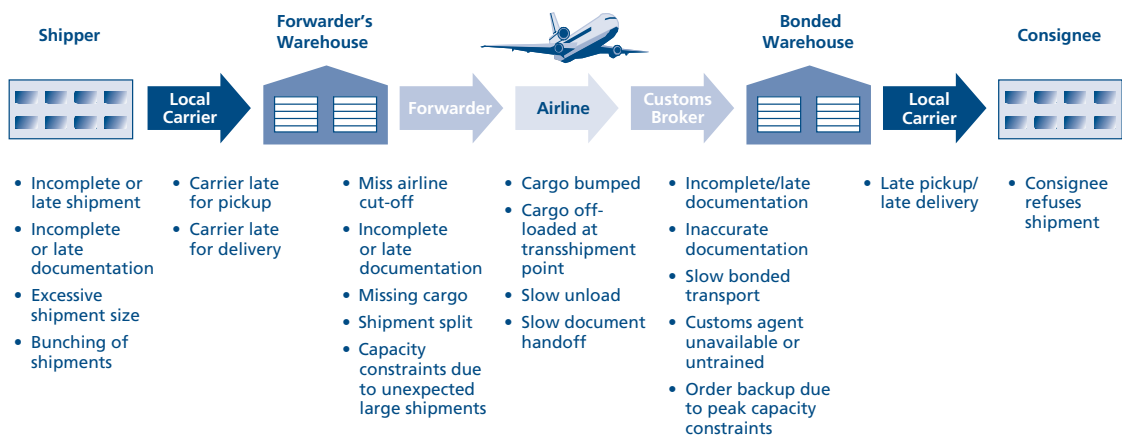
The process of negotiating terms and reaching agreement also is likely to be more time-consuming and difficult than would be the case with domestic suppliers, for a number of reasons, ranging from language barriers and travel requirements to differences in culture and business practices and legal/regulatory contract issues. Here again, local, hands-on expertise may make the difference in terms of maximizing projected savings and ensuring supplier relationships are well defined and comprehensive. Contracts must cover not only pricing, delivery, and payment terms, but must specify performance criteria at a sufficient level of detail, aligned with appropriate penalties/incentives

Due consideration must also be given to the fact that the “usual” way of communicating and resolving problems may be very different for the customer versus the supplier. Spelling out the proper channels and processes formally—and ensuring they are agreed to—can make a tremendous difference in creating an efficient, workable relationship. Best in class companies also provide suppliers with access to information “behind the firewall” to allow for timely issue resolution and communication with key project stakeholders. Such direct supplier access has proven useful in eliminating schedule delays, ensuring sustained quality in the development process, and avoiding cost overruns.

Making it Work

Implementation of international sourcing must focus first on the added complexities of getting goods from door to door. Weaknesses in the supply chain are accentuated in global sourcing situations. As shown in Exhibit 2, problems can occur at almost any point in the international sourcing supply chain, which is typically fragmented across multiple parties. Mode costs must be weighed against reliability requirements, and the selection of logistics partners will be as important as supplier selection: managing global logistics is difficult and many providers that claim they can do it actually can't.

Exhibit 2 **Typical International Supply Chain Problems**



Companies doing global sourcing seek transportation/logistics partners that can help them streamline the supply chain, improve reliability, and reduce landed costs. The large number of handoffs is a critical issue, one which can be minimized by transportation providers that can provide end-to-end “solutions” or at least oversee large components of the supply chain. Experience working in emerging markets is increasingly essential as well.

Selected opportunities also exist to provide innovative services for retailers and manufacturers. For example, grocery retailers that purchase general merchandise in Asia still must sort and package the goods into trailerloads at domestic distribution centers and then oversee distribution to stores. A logistics partner with sufficient overseas capabilities could take over a significant segment of this supply chain by offering to sort and package the goods at the point of origin and ship of trailers to destination ports closest to the stores—thereby taking advantage of lower costs in the originating country, as well as reducing transport costs.

The retailer/manufacturer also must put into place a comprehensive and focused process for managing the supplier at arm's length, to ensure contract compliance and minimize required oversight resources. In addition to the typical supplier management framework, there will be issues unique to foreign sourcing that must be addressed, such as:

- Customs clearance/management
- Reliability and consistency of performance

- Ongoing supplier development
- Global citizenship—e.g., acceptable labor and environmental practices
- Managing currency exchange risk

Where possible, elements of new global supplier relationships should be folded into the existing supplier management framework; differences such as those listed above, however, may require realignment on the part of the customer. The activities and possible pitfalls in managing international suppliers cut across all aspects of the purchasing organization, as illustrated in Exhibit 3.

Exhibit 3 Managing Global Supplier Relationships

Activity	Key Elements	Potential Pitfalls
People training and development	<ul style="list-style-type: none"> • Conduct global sourcing training to familiarize buyers with communication and ordering process • Introduce new logistics solution to category managers/buyers 	<ul style="list-style-type: none"> • Unclear expectations lead to confusion over ordering, lead times, minimum order quantities, etc.
Network design and rollout	<ul style="list-style-type: none"> • Implement and hone the logistics network for importing items from foreign supply base to home distribution centers • Evaluate need and implement temporary increase in inventory through transition period 	<ul style="list-style-type: none"> • Lack of dedication to project management impedes implementation • Stock outs
Supplier management process & systems integration	<ul style="list-style-type: none"> • Review procedures for modifications necessary to account for global supply base. Discuss key elements with supplier (i.e., performance measurement, issue resolution) • Align internal systems with supplier system capabilities 	<ul style="list-style-type: none"> • Suppliers not integrated into management process, not measured on the right elements or at all
New supplier start-up	<ul style="list-style-type: none"> • Manage the plan to phase-in new suppliers and phase-out old suppliers • Work closely with the internal customer and buyer to ensure smooth transition. Help trouble shoot issues that arise 	<ul style="list-style-type: none"> • Lack of dedication to project management (versus relationship management) impedes implementation

At best practice companies, continuous development of suppliers’ capabilities goes hand in hand with supplier management. For example, a Tier 1 automotive company with a longstanding China sourcing program has given its Beijing office the mandate to assist suppliers in improving their capabilities—and has even transferred “lean manufacturing” experts from North America to ensure that best-practice know-how and technology are put into practice.

Managing Risks

A final consideration in sourcing globally is that the potential risks can be far more severe than in local sourcing situations. Suppliers in emerging markets may not be as operationally sophisticated as domestic suppliers, resulting in greater risk of quality or performance issues. The political climate in some countries may be more volatile, potentially leading to business interruptions. And, differing views with regard to business ethics and financial transparency may need to be factored into business transactions in these markets. As a result, risk mitigation should be a part of any global sourcing initiative. As shown in Exhibit 4, solutions for managing and transferring risk include using risk assessment experts and specific insurance to cover the most critical risks in a given situation.

Exhibit 4 Global Sourcing Risk Factors and Mitigation/Transfer Options

Risk Factor	Risk Mitigation and Transfer
<ul style="list-style-type: none">• Supplier Risk—Risk of supplier fraud or inadequacies in operations, assets	<ul style="list-style-type: none">• Supplier intelligence assessment
<ul style="list-style-type: none">• Product Liability and Recall—Major issue when sourcing from emerging markets	<ul style="list-style-type: none">• Product liability assessment• Product recall insurance
<ul style="list-style-type: none">• Political Risk—Risk that political issues may interfere with fulfillment	<ul style="list-style-type: none">• Country risk assessment• Political risk insurance

Building a World-Class Capability

To summarize, companies with world-class global sourcing capabilities share the following characteristics:

- They apply a rigorous sourcing process that factors in the unique aspects of global markets
- They don't try to transform overseas suppliers into "clones" of the parent company, but rather focus on refining suppliers' current processes to map against their development principles
- They spend as much time and energy in optimizing the supply chain as they do in selecting the suppliers
- They identify and hedge against major risk areas, such as business interruption
- They proactively build a global sourcing organization to continuously improve sourcing capabilities

In global sourcing, focusing on the differences—rather than papering them over—can be an effective approach to developing sustainable and efficient international partnerships. There are still plenty of opportunities for retailers and manufacturers to refine their strategies as sourcing choices expand—and for transportation and logistics providers to build better businesses through integrated global logistics offerings.