

The great sourcing puzzle



Global sourcing is a seductive vision but it carries a price.
By Jim Preuninger

It has been said that companies don't have production lines anymore - instead they operate in a snap-together world in which almost anything can be outsourced and done offshore. And yet the paradigm of the 20th century economy is still with us - politicians talk about the manufacturing base and most still picture productive activity on an assembly line inside their own borders. The fact that such a model is largely uneconomic unless protected by trade barriers and subsidies shows that, left to free market conditions, industry has moved on.

There is little alternative. According to the US National Association of Manufacturers, in the past two years manufacturers have seen price increases of 65 per cent for metals, 50 per cent for fuel and natural gas, and 19 per cent for chemicals as well as the unprecedented peak for oil and petroleum prices. Many companies are being forced to absorb these costs internally to compete in markets that will not bear comparable finished goods price increases.

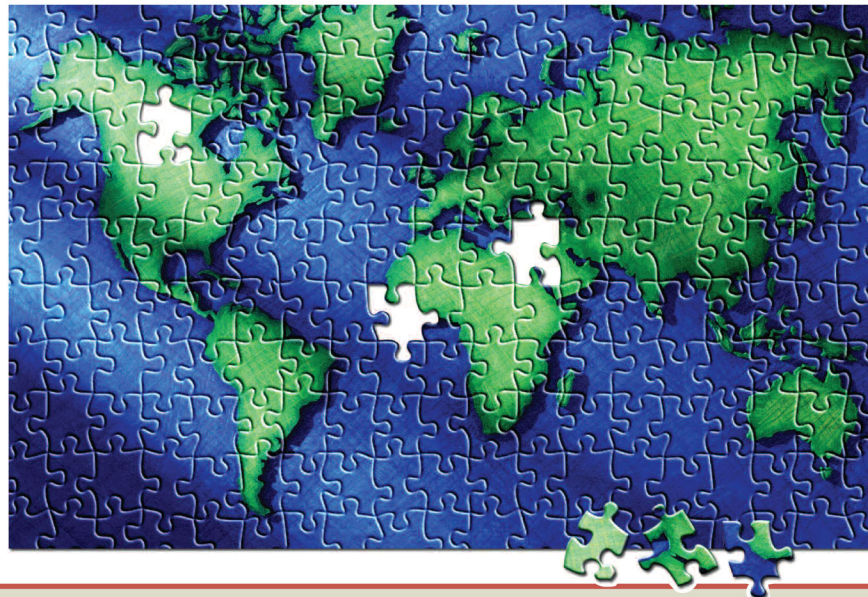
This then is one of the major reasons why companies seek out low cost sourcing and distribution strategies. In order to protect profits against a backdrop of political and

economic instability as well as downward price pressure from customers, manufacturers and retailers need to shift the scales in their favour. But they must also optimise the product cost/time to market balance - and in some cases this means the production of a single product is now spread over several countries and continents.

Global sourcing is a seductive vision but it carries a price. Evidence has shown that there are serious security and compliance issues associated with longer supply chains, particularly as the number and complexity of

trading partner relationships increases. Transit times and cash-to-cash cycles are also adversely impacted. For instance, a 10-day lead-time for products sourced in North America could increase to 12 weeks if sourced from China, with increased inventory carrying costs and significantly higher transport and logistics spend as a result.

One solution to this is to be able to model alternative sourcing and distribution strategies as a virtual "try before you buy" approach. The retailer or manufacturer can then compare the potential costs and risks involved



in shifting their supply base to China versus Eastern Europe, India or Mexico, or in developing new export markets where they have no prior commercial history.

Trade planning tools offer companies a way to make better informed sourcing and supply decisions by calculating the total landed cost of shipping from multiple origins to one destination, or vice versa. Available via the web, they enable the user to look up key factors that affect total delivered cost, including harmonised schedule (HS) product classification, import and export controls (eg quotas, duties, taxes, permits and licenses), freight and insurance costs, as well as security measures such as restricted or sanctioned party screening. At a glance, companies can see that although the origination costs for a certain commodity may well be cheaper in China, the time taken to bring finished goods to market, and the relative impact of trade quotas or tariffs means that they would actually benefit more from sourcing from Eastern Europe.

Such systems also help companies formulate a more agile trade strategy in response to changing economic conditions.

So, is this the manufacturing base of the future? My answer would be a qualified yes. The dilemma of global sourcing is that it will eventually be undermined by its own success as the vast discrepancies in per capita cost diminish due to the volume of investment. But the ability to pinpoint marginal savings will become increasingly valuable - as will the tools that allow such research to occur.

Jim Preuninger is CEO of Management Dynamics