Best Value Country Sourcing

A Paradigm Shift for Global Sourcing Approaches

Global CPO survey conducted by BrainNet EAC and Procurement Leaders Network
People Creating Connected Solutions
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At the end of 2008 the international financial and economic market situation seemed reminiscent of Roland Emmerich’s disaster movie “The Day after Tomorrow”, where global climate warming causes out of control weather conditions and leaves mankind facing terrible natural catastrophes. In reality, we are now experiencing the overheating of financial markets, with business pages frequently issuing disaster warnings.

However, just as in the movie, the world doesn’t stop turning and neither will the global flow of goods fall on its knees. The twenty-first century’s global economy is unforgiving, therefore corporate strategies have to map the complexity of international value creation chains more comprehensively and more accurately than ever before. In the procurement sector, this means an evolution from Low-Cost Country Sourcing via Best Cost Country Sourcing to Best Value Country Sourcing. This approach aims to strengthen the company’s entire supply chain, focusing not only on cost optimization but on long-term value creation.

In this context, there are three key stages of action that need to be actively addressed: firstly, the choice of best sourcing regions. Increasingly, traditional cost criteria will be supplemented by other factors such as environmental concerns, legal framework conditions or the availability of specialist staff.

Secondly, a company’s organization and internal processes need to keep pace with external changes. If more and more factors are brought to bear on the choice of sourcing regions, a company would be well advised to promote the integration of its functional areas in order to take adequate account of all influencing factors.
Thirdly, training and skills are crucial: further training measures that provide employees with the technical knowledge to do their job effectively should not be left until better times.

The current crisis is global and this is what makes its impact so serious. It also means that everyone needs to battle tougher framework conditions. Best Value Country Sourcing provides an opportunity to actively shape each individual company’s competitiveness and thus lead it successfully into “the years after tomorrow”.

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2. Cost Alone is no longer a Good Enough Incentive

By David Rae

The appeal of low-cost country sourcing during the last decade has been so great that few procurement leaders questioned its wisdom. As a result, the recent growth of western economies can be directly linked to the success of emerging economies such as China, Vietnam, Brazil, India and, to an increasing degree, Eastern Europe and Russia.

But it seems the party is over. Rising inflation, corruption, poor legislative frameworks and infrastructures and, at least during the first half of 2008, a huge increase in the cost of logistics, have all tarnished the image, and appeal, of many of these sourcing locations.

Corporate and consumer moods have also changed. With the rise of sustainability up the corporate agenda and a global recession shifting the focus of corporate spending, procurement departments are increasingly looking to local sourcing as an antidote.

However, globalisation is an irreversible phenomenon. The crucial difference is that cost alone is no longer a good enough incentive or measure. Corporate buyers must look beyond simple cost to total cost of acquisition to ensure they get the best long-term supplier relations for their companies.

It’s a subtle, but important shift and is one that can been seen from the responses to some of the questions in this survey. Environmental, ethical and labor considerations are all seen as growing in importance, for example.

Every sourcing destination has its positives and negatives. China is seen as high risk for loss of intellectual property, CSR and product quality; Russia for political risk; Brazil is seen as high risk specifically because of currency issues; India for its infrastructure and CSR; and Eastern Europe for rising labor costs. In short, every low-cost sourcing destination
has its own set of challenges. And all of these challenges must be taken into account and considered before any intelligent decision can be made.

This research project, conducted among the readers of Procurement Leaders magazine provides a starting point. It offers insight into the views of procurement executives who are deeply involved in global sourcing, many of whose opinions and strategies are changing.

And it’s a good job they are, because the world is changing too.

David Rae
Editorial Director, Procurement Leaders Network
Global sourcing has always been an issue of uncertainty, primarily due to the fact that cross-border sourcing decisions require a multifactorial in-depth analysis. Labor costs, logistical infrastructure, local, cultural, legal and political characteristics, compliance, and risk management issues are just some examples of factors which should be taken into account and which contribute to the complexity of such processes. That may be the main reason why so many international sourcing decisions did not pay off as they were expected to, or were even detrimental.

Fortunately this led not to a total withdrawal from global markets, but to more differentiated and sophisticated sourcing strategies: departing from a low-cost country sourcing approach, which was mainly based on labor and material cost comparisons and has proven insufficient, global companies are now increasingly shifting to what we call a Best Value Country Sourcing (BVCS) approach. This new perspective, which has been gaining ground for about three years now, is based on the insight that labor cost and product quality are just two aspects – important though they may be. On the one hand factors like

**Paradigm shift in procurement**

<table>
<thead>
<tr>
<th>from Low Cost Country Sourcing</th>
<th>to Best Cost Country Sourcing</th>
<th>to Best Value Country Sourcing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LCCS</strong></td>
<td><strong>BCCS</strong></td>
<td><strong>BVCS</strong></td>
</tr>
<tr>
<td>■ Sourcing approach solely based on the selection of supply in view of cost advantages and exploitation of cost arbitrage between geographies</td>
<td>■ Cost-driven sourcing strategy implying the principle of Total Cost of Ownership (TCO) and further qualitative factors to achieve “best performance”</td>
<td>■ Best practice sourcing approach based on TCO, considering cost-, qualitative- and logistic dimensions with overall focus on value creation</td>
</tr>
<tr>
<td>■ Short-term strategy</td>
<td>■ Long-term approach</td>
<td>■ Sustainable approach</td>
</tr>
</tbody>
</table>

management costs, supply guarantee, IP protection, sustainability, and supplier reliability are starting to take on greater relevance. On the other hand value oriented topics like value creation through innovation sourcing or innovation partnerships with suppliers are gaining strategic importance. That means that a low-cost country is not automatically a Best Cost Country for a certain product category, company or industry.

But that won’t be the end of the procurement evolution. Tough global competition and scarcity of natural resources, and in turn the need to reduce costs and raise efficiency, will force companies to reconceptualize their view on procurement. This paradigm shift will lead to a perception of procurement not as a cost factor or cost manager but as a value driver and value creator. That’s why we are convinced that the future of sourcing is most appropriately described as the Best Value Country Sourcing approach.

The present international global sourcing study by BrainNet EAC and Procurement Leaders Network documents the first signs of this trend. Although the CPO survey proves that the future won’t be totally different, it shows that additional factors and trends will also have a deep impact on sourcing strategies.
The survey was carried out online in September and October 2008 – precisely when the global financial crisis had become dramatically worse. For the 155 CPOs and Senior Executives from SCM all over the world that took part in the study, this therefore provides a “backdrop” for all their strategic and future-focused statements. Managers from all the key industries were surveyed, with industrial manufacturing, oil and chemicals, banking and financial services being particularly strongly represented. Here too, these are industries that have so far been particularly severely affected by the impacts of the financial crisis.
Western European companies account for a large proportion of the respondents. However, the study does cover all the relevant sourcing markets and provides an impression of the regional particularities of strategy development.

Responses by region

- Western Europe: 75%
- Asia: 9%
- North America: 4%
- MENA: 2%
- Africa: 1%
- Eastern Europe: 1%
- Other Latin America: 1%
- Others: 2%

1) Including Fenno-Scandinavia
2) Including Australia, Pakistan
3) Including Russia

crisis. It is clear that the experiences of the last few months and weeks are therefore also having a strong impact on the forecasts for the future development of procurement.
Beyond this, a disproportionately high number of major companies are represented from every region and industry. 60% of the survey participants represent a turnover of 5 to > 10 € bn and 56% have a purchase volume of at least 1 € bn. These companies and their decisions have a particularly powerful influence on the strategic trends of the entire market.

### Participants' turnover and procurement volume

#### Turnover (in € bn)

- **<0.1**: 5%
- **0.1–0.5**: 7%
- **0.5–1**: 11%
- **1–5**: 17%
- **5–10**: 13%
- **>10**: 47%
- **60% > 5 € bn**

#### Procurement volume (in € bn)

- **<0.05**: 5%
- **0.05–0.1**: 5%
- **0.1–0.5**: 18%
- **0.5–1**: 17%
- **1–3**: 15%
- **3–5**: 10%
- **>5**: 31%
- **56% > 1 € bn**
The respondents are exclusively decision-makers with direct influence on strategy design from purchasing or other departments responsible for this issue. Those surveyed have on average 13 years of experience in purchasing.

This study therefore surveyed the leaders that to a large degree shape the determining trends in purchasing themselves. At the same time, however, they are also the individuals most affected by the change. It is their responsibility to draw the development lines for the future in difficult times characterized by high dynamism.

Responsibilities of participants

<table>
<thead>
<tr>
<th>Role</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Procurement</td>
<td>142</td>
</tr>
<tr>
<td>Supply Chain Management</td>
<td>53</td>
</tr>
<tr>
<td>Logistics</td>
<td>33</td>
</tr>
<tr>
<td>Operations</td>
<td>16</td>
</tr>
<tr>
<td>Finance</td>
<td>3</td>
</tr>
<tr>
<td>Others</td>
<td>16</td>
</tr>
</tbody>
</table>

Job titles of participants

- CEO: 1%
- VP/Senior Manager: 19%
- CPO: 21%
- Senior VP /Director: 11%
- Manager: 29%
- Others: 19%

1) Multiple answers possible
5. Best Value Countries for Sourcing Approaches

5.1. Halfway to a New Paradigm
– Decision-making Criteria for Global Sourcing

If we were to identify the BVCS approach as a new paradigm in the development of procurement, then this wouldn’t be completely correct from a theoretical point of view. This is because a paradigm shift requires a clean break with the assumptions of the past.

With BVCS, this is not the case, since the key reasons for staying with sourcing abroad remain current – similar to the replacement of the LCCS approach by the BCCS philosophy. This is also confirmed by the study results: quantitative factors are still key reasons to source outside the home market.

At the same time, the study shows that best value factors such as flexibility, ethical reasons and labor availability are gaining more importance. Central – and it is from this that we derive the justification for talking of a paradigmatic change – is the substantial broadening of perspectives and the associated change from a purely cost-focused to an also value-oriented standpoint.
### Key reasons for sourcing outside the home market

<table>
<thead>
<tr>
<th>Reason</th>
<th>High importance</th>
<th>Medium importance</th>
<th>Low importance</th>
<th>Growing importance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low labor costs</td>
<td>56%</td>
<td>33%</td>
<td>9%</td>
<td>2%</td>
</tr>
<tr>
<td>Low raw material costs</td>
<td>49%</td>
<td>26%</td>
<td>24%</td>
<td>1%</td>
</tr>
<tr>
<td>Flexibility in production and supply</td>
<td>34%</td>
<td>37%</td>
<td>15%</td>
<td>14%</td>
</tr>
<tr>
<td>Access to highly qualified workforce</td>
<td>31%</td>
<td>39%</td>
<td>20%</td>
<td>10%</td>
</tr>
<tr>
<td>Shorter delivery times</td>
<td>30%</td>
<td>33%</td>
<td>21%</td>
<td>16%</td>
</tr>
<tr>
<td>Low capital costs</td>
<td>29%</td>
<td>34%</td>
<td>37%</td>
<td></td>
</tr>
<tr>
<td>Better access to raw material sources</td>
<td>27%</td>
<td>37%</td>
<td>33%</td>
<td>3%</td>
</tr>
<tr>
<td>Reduction of logistic costs</td>
<td>27%</td>
<td>34%</td>
<td>25%</td>
<td>14%</td>
</tr>
<tr>
<td>Sourcing of innovation</td>
<td>27%</td>
<td>29%</td>
<td>34%</td>
<td>10%</td>
</tr>
<tr>
<td>Risk mitigation</td>
<td>25%</td>
<td>45%</td>
<td>18%</td>
<td>12%</td>
</tr>
<tr>
<td>Localization of goods and services</td>
<td>22%</td>
<td>41%</td>
<td>27%</td>
<td>10%</td>
</tr>
<tr>
<td>Ethical reasons</td>
<td>22%</td>
<td>16%</td>
<td>42%</td>
<td>20%</td>
</tr>
<tr>
<td>Quality improvements</td>
<td>20%</td>
<td>34%</td>
<td>34%</td>
<td>12%</td>
</tr>
<tr>
<td>Necessity to enter new sales markets</td>
<td>20%</td>
<td>28%</td>
<td>38%</td>
<td>14%</td>
</tr>
<tr>
<td>Cost advantages from exchange rate differences</td>
<td>18%</td>
<td>36%</td>
<td>39%</td>
<td>7%</td>
</tr>
<tr>
<td>Tax optimization</td>
<td>16%</td>
<td>22%</td>
<td>56%</td>
<td>6%</td>
</tr>
<tr>
<td>Quality adoption to local market requirements</td>
<td>14%</td>
<td>31%</td>
<td>49%</td>
<td>6%</td>
</tr>
<tr>
<td>Local content requirements</td>
<td>12%</td>
<td>36%</td>
<td>45%</td>
<td>7%</td>
</tr>
<tr>
<td>Environmental reasons</td>
<td>12%</td>
<td>25%</td>
<td>37%</td>
<td>26%</td>
</tr>
</tbody>
</table>
There are significant differences between the individual industries. The manufacturing industry, for instance, focuses on cost-driven sourcing opportunities. The service industry, on the other hand, is increasingly focusing on qualitative factors. The weighting of the individual criteria, however, is clearly shaped by the prevailing value creation structures and corresponding value and cost drivers.

Key reasons for sourcing outside the home market – by industry

<table>
<thead>
<tr>
<th>Industrial manufacturing</th>
<th>Oil and chemicals</th>
<th>Banking and financial services</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. 1: Low labor costs (45%)</td>
<td>No. 1: Low raw material costs (100%)</td>
<td></td>
</tr>
<tr>
<td>No. 2: Low raw material costs (42%)</td>
<td>No. 2: Better access to raw material sources (55%)</td>
<td></td>
</tr>
<tr>
<td>No. 3: Shorter delivery times (37%)</td>
<td>No. 3: Reduction of logistic costs (42%)</td>
<td></td>
</tr>
<tr>
<td>No. 4: Flexibility in production and supply (33%)</td>
<td>No. 4: Low labor costs (36%)</td>
<td></td>
</tr>
<tr>
<td>No. 5: Localization of goods and services (30%)</td>
<td>No. 5: Low capital costs (36%)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pharmaceuticals</th>
<th>Telecommunications</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. 1: Low labor costs (60%)</td>
<td>No. 1: Access to highly qualified workforce (67%)</td>
</tr>
<tr>
<td>No. 2: Low raw material costs (60%)</td>
<td>No. 2: Low labor costs (63%)</td>
</tr>
<tr>
<td>No. 3: Necessity to enter new sales markets (60%)</td>
<td>No. 3: Localisation of goods and services (50%)</td>
</tr>
<tr>
<td>No. 4: Flexibility in production and supply (40%)</td>
<td>No. 4: Flexibility in production and supply (43%)</td>
</tr>
<tr>
<td>No. 5: Low capital costs (40%)</td>
<td>No. 5: Sourcing of innovation (43%)</td>
</tr>
</tbody>
</table>
5.2. Up and Away? – The Global Shift of Sourcing Volumes

The weighting of the individual criteria for sourcing decisions is also directly linked to what regions come into the companies’ radar as procurement markets. Despite all the industry-specific differences, there is however one clear trend: by 2013, a shift of up to 24 € bn in procurement volume out of Western Europe will take place – with the markets benefiting most being India and Eastern Europe. These figures

Importance of regions as BVCS markets and shift of procurement volumes 2008–2013

<table>
<thead>
<tr>
<th>Range of procurement volume spending</th>
<th>Change 2008–2013 (in %)</th>
</tr>
</thead>
</table>

1) Calculation model: Sum of participated companies’ range of procurement volume set off against the percentage sourced in each market
2) Country growth ratios considered for change rate 2008-2013
show that Western Europe and NAFTA may well remain the most important procurement zones for the foreseeable future, but their significance will wane as resident companies are reducing their home region sourcing activities. It is interesting to note here that the possibilities of a market are regarded differently by domestic and foreign companies. The North American market, for example, continues to remain

Primary sourcing markets for German and U.S. companies

![Graph showing sourcing market focus, Germany]
a dynamic one for German companies, while home sourcing is significantly falling away. North American companies regard the situation as a complete mirror image. They are reducing their home sourcing volumes and see Western Europe as having slight growth potential.
Companies from both countries, however, will in the future focus on China, India and the Middle East – whereas Asian companies regard Africa and Other Latin America as the emerging sourcing markets besides their own region. In Western Europe, it is primarily blue chips that focus particularly heavy on China and India and distance themselves from their home markets. Small companies and mid-caps, on
the other hand, focus more heavily on upcoming sourcing markets such as Eastern Europe, Russia and the Middle East, and remain more strongly linked to their home markets. One key reason for this is without doubt the significantly greater complexity and cultural difference of the Asian markets, and with this the higher need for specific expertise and a local presence.
There are also significant differences in terms of the individual industries. Industrial manufacturing and the oil and chemical industry see especially the Middle East and India as future procurement platforms. The service industry and telecommunications focus on China, while banking and financial services are pulling back from the Indian sourcing market.

India and China – these two giants appear to stand in a certain correlation to each other. The financial services providers, for example, that were active very early on in India, are shifting their focus to China. In contrast, for the manufacturing industry, which is one of the pioneers of China sourcing, India is becoming increasingly important, while China’s growth potential is reaching its limits.

**Sourcing market focus by industry**

[Graph showing sourcing market focus by industry for different regions and years (2008, 2013).]
On the one hand, the industry-specific reasons for sourcing beyond home markets play a key role in these decisions. Access to highly qualified personnel, for example, is very important for business service companies. That's why China's and India's consistent qualification strategies are starting to pay off. Another example is the growing importance of the Middle East for the oil and chemicals industry, for which it is of crucial importance in strategic terms to be anchored in this oil-rich region.

The second key decision factor lies in the specific problems of the individual sourcing markets.
Taking a look at these regional bottlenecks, it becomes immediately clear that individual BVCS criteria have gained massively in importance. Without doubt, the most important aspects are the environment and legal certainty. The lack of environmental standards is a major sourcing obstacle in virtually all potential sourcing regions. Legal certainty – which also includes the issues of political risk, fraud, intellectual property and compliance – is the most important reason why Western Europe and NAFTA remain the leading sourcing regions despite all the shifts in focus.

The conventional calculation of outsourcing decisions is altered by the fact that the labor costs are currently undergoing massive increases both in China and in Eastern Europe. For companies from Western Europe, the objective on the one hand – and this is also reflected by the survey – is to move into new sourcing regions and primarily regard sourcing regions not just from a cost perspective, but also from a value perspective. The fact that this is increasingly the case is evidenced by the major importance of innovative capacity among suppliers – one of the main stumbling blocks in Eastern Europe.
Overview: Top 5 sourcing obstacles by region

**Brazil**
- No. 1: Currency risk (44%)
- No. 2: Lack of qualified workforce (32%)
- No. 3: Trade regulations/customs (29%)
- No. 4: Missing environmental standards (27%)
- No. 5: No innovation from suppliers (26%)

**India**
- No. 1: Missing standards for sourcing governance (56%)
- No. 2: Missing environmental standards (55%)
- No. 3: Poor infrastructure (53%)
- No. 4: Increasing labor costs (41%)
- No. 5: Quality problems (32%)

**China**
- No. 1: Missing environmental standards (77%)
- No. 2: Loss of intellectual property (73%)
- No. 3: Missing standards for sourcing governance (67%)
- No. 4: Fraud/compliance (64%)
- No. 5: Increasing labor costs (60%)

**Eastern Europe**
- No. 1: Increasing labor costs (47%)
- No. 2: Fraud/compliance (28%)
- No. 3: No innovation from suppliers (27%)
- No. 4: Bad/missing local supplier performance management (27%)
- No. 5: Missing environmental standards (26%)

**Russia**
- No. 1: Political risks (76%)
- No. 2: Fraud/compliance (61%)
- No. 3: Trade regulations/customs (53%)
- No. 4: Missing environmental standards (47%)
- No. 5: Currency risks (46%)

1) (x%) = percentage of responses by region
5.3. Sourcing ID Cards – Regional Profiles

If one considers the most important sourcing reasons set out above, as well as the bottlenecks that arise in a sourcing market, then sourcing profiles can be drawn up for the various individual regions. This can be illustrated using the examples of China and India.

Companies sourcing in China are mainly large in turnover and handled procurement volume. Their product sourcing focus lies primarily on direct materials. The main incentive for purchasing in China is primarily low-cost factors.

This situation will however change over the next few years. On the one hand due to rising wage costs – especially in the booming economic centers. On the other hand due to a fundamental change in the Chinese economy – China is increasingly evolving from being a technical specialist to becoming a nation of engineers, which offers completely different prospects from the cheap purchasing of simple materials and products. At the same time, the Chinese government is now making efforts to eliminate the bottlenecks outlined above, especially the highly problematic treatment of the environment and the issue of expertise piracy. In every case, activities on the Chinese procurement market will also in the future require a strong local presence – companies that buy heavily in China already have 19 percent of their purchasing staff on site. “Local-for-local” sourcing, for which the Chinese market is predestined for a range of economic and political reasons, will advance this trend further.
Company sourcing profile for China

Evaluation of all companies which obtain at least 30% of their total procurement volume in China

Primary nature of business
- Telecommunications: 27%
- Consulting: 5%
- IT: 7%
- Energy and mining: 7%
- Banking and financial services: 7%
- Oil and chemicals: 13%
- Retail and leisure: 13%
- Others: 7%
- Industrial manufacturing: 20%

Turnover (in € bn)
- <0.1: 13%
- 0.1–0.5: 7%
- 0.5–1: 7%
- 1–5: 13%
- 5–10: 13%
- >10: 47%

Procurement volume (in € bn)
- <1: 39%
- 1–5: 14%
- >5: 47%

Product sourcing focus
- Components
- Raw materials
- Modules
- Services
- Indirect materials
- MRO
The situation in India is comparable. Here too, the picture is dominated by major companies with a strong local presence of purchasing experts. The services industry, which prevails among the industries, primarily buys services and indirect materials in India. The most important driving factor for sourcing in India is the low wage costs. But the commitment to the subcontinent is also being driven by a growing number of skilled staff and the desire for localization.

The Indian sourcing profile will also change rapidly. India already has relatively high legal certainty that favors the sourcing of complex and therefore expertise-intensive goods. The country is also on the way to skipping an entire development cycle and becoming a leading service and know-how supplier. The country’s high socio-cultural complexity, the very different suitability of individual regional clusters for certain industries and the dynamic change processes require the presence of a strong and highly qualified procurement crew on site. Just like China, India is also a typical market not only for international sourcing but also for the “local-for-local” approach.
Company sourcing profile for India

Evaluation of all companies which obtain at least 30% of their total procurement volume in India

- **Primary nature of business**
  - IT: 20%
  - Energy and financial services: 20%
  - Oil and chemicals: 20%
  - Others: 20%

- **Turnover (in € bn)**
  - >10: 40%
  - 5–10: 20%
  - 0.5–1: 20%
  - 0.1–0.5: 20%
  - Others: 20%

- **Procurement volume (in € bn)**
  - <1: 60%
  - 5–10: 40%
  - >5: 20%

- **Product sourcing focus**
  - Services: high
  - Indirect materials: low
  - Components: low
  - Modules: low
  - Raw materials: low
As the financial crisis in the United States spreads around the world, China appears to be relatively safe. With government-owned land, higher quality mortgages, a closed financial system and $1.8 trillion in foreign exchange reserves, the country is unlikely to face a similar economic crisis. However, with the combined effect of the slowing global economy and a weakening demand in major markets, the impact it may exert upon the Chinese economy remains huge.

According to the procurement managers’ index (PMI) announced by the China Federation of Logistics and Purchasing, the sub-index for new export orders was 48.4 points in September, dropping 2.3 points from a month earlier, while the purchasing sub-index plunged to 44.7 points – the first time it fell below 50 since 2006. 67,000 factories of various sizes were shut down in China in the first half of 2008, 100,000 plants will be shut down by the end of 2008. Experts predict that the number of suppliers actively serving the U.S. apparel sector would drop over 70% in just three months, falling from 22,099 suppliers in July to just 6,262 in October. At least 2.7 million factory workers in southern China stand to lose their jobs after the demand for electronics and toys slowed considerably and the Chinese government warns that massive unemployment could spark unrest.

The financial crisis exacerbated the decline of China's cost advantage. With the devaluation of the international currencies, the Chinese Yuan has continued to revalue, which raises the cost of labor force and raw materials in China. China’s low-cost advantage is no longer distinct, especially regarding the labor-intensive and low-cost manufacturing industries. And to prevent the risk of exchange rate fluctuations, many export enterprises have changed long-term orders into short-term ones, and large orders into smaller ones.

The financial crisis has forced the companies to cut operational costs among the supply chain. One possible measure that the global retailing companies are likely to take is to shorten their supply chains in order to minimize risk and inventory while improving cash flow. The end effect will be a reduction in exports from China to the US and Europe. This is already indicated by the 2.2 percent drop in Chinese exports in November last year (measured on an annual basis), which is in stark contrast to the 26 percent increase in exports one year earlier. The situation is likely to prevail as long as consumer confidence in the West remains weak, with certainty for a good part of 2009 and potentially until 2010.

Dr. Martin Lockström

Director SMI China
5.5. India Sourcing Outlook

By Prof. Dr. Roger Moser

Like every other economy of the world India is affected by the global crisis. The most obvious and visible impact is the decreased business for the BPO (business process outsourcing) companies in metropolises like Bangalore, Hyderabad or the National Capital Region. This development has accelerated a strategy change of many BPOs in India which have realized that their business is too much depending on the US companies (often 60% or more of their revenues). Therefore, the BPO sector is currently facing the challenge to grow their business preferably in Continental Europe, with a strong focus on Germany and to manage their human resources by balancing lay-offs, new hirings and training efforts in the short and mid-term perspective. The financial and subsequently the economic crisis have also fostered a consolidation process where those Indian companies are the winners that still have access to cash reserves – which are primarily the big ones. So, in the mid-term we will see many small, specialized BPO companies integrated into the BPO biggies.

Looking at the manufacturing industry it’s necessary to distinguish between the few global players and the companies that produce primarily for the local markets. While the local players are mainly affected by the financial crisis and the subsequent problems, the global players are hit by both the problems in the financial sector and the recession in the US and Europe. The positive aspect of the situation, especially concerning the automotive component suppliers, is that almost every OEM has now turned his/her eyes on India. Companies which will be able to sustain the current crisis successfully might benefit from an even increased business volume in 2-3 years.

This development has grave consequences to sourcing and supply chain management. First of all, it’s time to develop strategies which can be used to lower prices not only in the short run but rather in a sustainable way. Today many BPO companies are looking for long-term engagements with European companies and are willing to offer their services today at a much lower rate than 6 months before. This allows achieving high value-to-cost ratios without affecting the quality of supplier relationship. Beyond it many OEMs will have to take a much closer look at their supply chain in India. A significant number of excellent suppliers are heavily affected by cash management problems. Therefore an integrated approach to supply risk management is necessary in order to decide how struggling suppliers can be supported. The bet on government support might be the wrong choice, as the political system in India is still not ready to react on such issues efficiently.

Prof. Dr. Roger Moser

Director SMI India
6. The World Needs a Universal Sourcing Governance Codex

By Prof. Dr. Christopher Jahns

In order to explain why the world needs a universal sourcing governance codex it is necessary to ask which role procurement plays in modern economy. This question, given the volume of empirical and practical experience with the issue, appears to be rhetorical. However, we’re going to look at the matter from a different perspective, a perspective that sets the underlying tone in this study.

Procurement is the network that binds a company most strongly to its environment – even more strongly and even more diversely, for instance, than sales. It is purchasing that puts out feelers for the company in strange, new regions and that is the first to face the idiosyncrasies, the cultural, ethical, social and religious characteristics of a region. It is to a very large extent purchasing that has to estimate and also lift the long-term value creation potential of a region – an activity that goes much deeper than, say, a simple estimate of sales potential.

Procurement aims not simply to open up regional economic and societal structures, but – as a consequence of the falling value creation depth caused by globalization and modern management approaches – to integrate these firmly into its own structures. It is therefore far more than just a modern business traveler. It is an ambassador. It would be entirely too simplistic, however, to label procurement – as described by one popular formula – as a company’s messenger. From the perspective of Western Europe and North America especially, procurement plays the role of the diplomatic representative of the occidental system of values and is also perceived as such. It does not need to be mentioned that in the last century the West has not always set a good example in this context. Equally, there is no need to point out the difficult and long-term consequences of this.

Even today, for demagogues such as Hugo Chavez or Mahmoud Ahmedinejad, they form the sounding board for their propaganda. New players in the global sourcing arena are also faced with the issue of a codex of behavior, with China first in line.
The opportunities that the advancing globalization and integration offer to all players are tremendous. Even the current economic crisis will not reverse this trend – this much we know. Procurement is one of the most important bastions of this process. It is therefore all the more important nowadays to establish globally binding guidelines for sourcing. It is in the interests of the whole of the global economy, to stamp out corruption and shady dealings, child labor and environmental destruction, product piracy and faulty, dangerous goods. These are all problems that procurement specialists have to face on a daily basis.

To date, there is absolutely no explicit sourcing governance codex. There are empirical national approaches, such as the newly unveiled code of conduct by the Federation of Materials Management, Purchasing and Logistics (BME) in Germany. But what impact do national codices have in an economy that operates on a global scale? And how extensive are the opportunities to get around these rules? A global and networked economy requires universal game rules that are based on international consensus and the commitment of all the key players – both in the West and in upcoming countries such as China, India or Russia. Developing a sourcing governance codex such as this and bringing it to life is a task to be shared by the entire global economy, national governments and international institutions. It needs to be addressed – now.

Prof. Dr. Christopher Jahns
Dean and CEO EBS European Business School and Executive Director Supply Chain Management Institute (SMI)
7. Procurement Organization – Some Key Elements

7.1. In the Spotlight – Transparency and Supervision in Global Sourcing

Key factors that decide on the success or indeed failure of global sourcing initiatives include the transparency of processes and clear organization. The assurance of these factors represents a challenge for every organization. Positive effects from the distribution of procurement volumes across the globe cannot infrequently fizzle out if the controlling and management systems cannot cope with the complexity involved. An industry comparison shows significant differences with regard to transparency of purchase volume and supervision by a central department.

Pharmaceuticals, oil and chemicals, IT, manufacturing and logistics in particular exhibit a relatively high degree of structuring in their sourcing activities. On the other hand, consumption industries in particular are falling behind markedly. These differences are to a considerable degree a result of the industry-typical value creation structures and processes. The many publicized problems experienced by the end consumer oriented industries in terms of quality assurance in global sourcing especially show that, as far as clear and transparent controlling of procurement processes is concerned, there is an urgent need for action.

In regard to transparency and supervision, there are not only industrial but also regional peculiarities. Less surprisingly, it turns out that Western Europe holds a very good position in both respects, while Asia ranks last. It is interesting, however, that the North American
## Transparency and supervision of procurement structure by industry

<table>
<thead>
<tr>
<th>Industry</th>
<th>Average share of transparent procurement volume (in %)</th>
<th>Average share of total spending volume processed under the direct supervision of SCM department (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and chemicals</td>
<td>88%</td>
<td>85%</td>
</tr>
<tr>
<td>Information technology</td>
<td>79%</td>
<td>77%</td>
</tr>
<tr>
<td>Industrial manufacturing</td>
<td>76%</td>
<td>69%</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>74%</td>
<td>66%</td>
</tr>
<tr>
<td>Logistics and transportation</td>
<td>73%</td>
<td>65%</td>
</tr>
<tr>
<td>Utilities</td>
<td>73%</td>
<td>65%</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>68%</td>
<td>65%</td>
</tr>
<tr>
<td>Retail and leisure</td>
<td>65%</td>
<td>59%</td>
</tr>
<tr>
<td>Energy and mining</td>
<td>60%</td>
<td>57%</td>
</tr>
<tr>
<td>Banking and financial services</td>
<td>52%</td>
<td>55%</td>
</tr>
<tr>
<td>Media and entertainment</td>
<td>49%</td>
<td>50%</td>
</tr>
<tr>
<td>Consulting</td>
<td>40%</td>
<td>45%</td>
</tr>
<tr>
<td>Aviation</td>
<td>38%</td>
<td>34%</td>
</tr>
</tbody>
</table>

companies also have looser controlling structures and achieve scarcely higher values here than their Asian colleagues – in a regional comparison, the United States rank behind India in this respect.

Regional differences are apparent also when it comes to the distribution of procurement staff across the globe. In this area, North American and Western European companies in principle follow similar strategies, with the Western European companies bundling their strengths more strongly in their headquarters than North American companies. This is evident for instance from the stronger presence of Americans in Eastern Europe – a de facto natural sourcing market for Western Europeans. A look at Asian companies reveals a different picture: the purchasing teams in this domain are distributed much more widely across the world.

**Allocation of procurement staff by region**

- **Western European companies**
  - Western Europe: 53%
  - NAFTA: 15%
  - Other Asia: 9%
  - India: 7%
  - Russia: 4%
  - Eastern Europe: 4%
  - Africa: 2%
  - Others: 1%

- **North American companies**
  - Western Europe: 28%
  - NAFTA: 43%
  - Other Asia: 6%
  - India: 8%
  - Russia: 6%
  - Eastern Europe: 5%
  - China: 6%
  - Others: 2%

- **Asian companies**
  - Western Europe: 36%
  - Other Asia: 32%
  - NAFTA: 15%
  - China: 15%
  - India: 8%
  - Russia: 4%
  - Eastern Europe: 1%
  - Others: 2%
7.2. Cross-border Decision Making – Functional Involvement in Global Sourcing

The growing complexity of sourcing processes and the wide focus on the issue brought about by the BVCS approach also requires the significantly greater integration of central corporate functions than is currently still the case. On the one hand, their expertise is needed to make sound decisions in terms of criteria such as currency risks, political uncertainties or tax optimization. On the other hand, sourcing decisions have an immediate influence on areas such as research and development or production. Many companies have since realized this, as the graphic below illustrates, and are planning to link their purchasing with other corporate functions more closely.

Development of departments’ involvement in global sourcing decisions

![Graph showing the growth of importance of different departments in global sourcing decisions from 2008 to 2013.]

- Procurement (-1%)
- R&D (+10%)
- Logistics (+10%)
- Finance (+17%)
- Marketing (+6%)
- Sales (+9%)
- HR (+9%)
- Production (+6%)

1) (x%) = growth of importance 2008–2013
One trend here in particular deserves attention: the strongest-growing importance of finance (+17%), R&D and logistics (+10% each) in sourcing decisions. In individual industries, the shifts are even more dramatic: the degree of involvement of the R&D department, for example, in the pharmaceuticals industry, will increase by 40 percent and the finance department will increase in significance by 46 percent in industrial manufacturing.

These changes are not surprising per se. In recent years, it has become more and more apparent that the financial side of purchasing – the financial supply chain management – has a significant impact on a company’s overall performance. In the global financial crisis especially, close collaboration between the procurement and finance departments is worth real money. Tools such as tax and working capital optimization or supply chain financing improve – from purchasing outwards – the overall organization’s liquidity status. At the same time, there has been and still is a huge gap between the purchasing and finance departments. Cooperation processes are not established to an adequate degree.

In terms of R&D and logistics too, more networking with purchasing is an obvious step: the majority of future product costs are defined already in the development phase, which consequently assigns purchasing a central role. The integration of the logistics department ultimately comes from the increasing tendency to no longer control purchasing and logistics as discrete sections, but rather integrate them as part of an end-to-end supply chain management system.
Industrial companies’ perspective on their supply chain networks has fundamentally changed in the last years. Tough competition, increasing complexity of manufacturing processes and short product life cycles require holistic strategies. That means a sustainable step-up in efficiency can only be reached when the partner network is actively involved in process optimization. That’s why today’s suppliers meet their customers at eye level. They are involved in R&D processes as well as in quality management or financial and logistic operations. In fact, the industrial world is increasingly shifting from pure cost oriented to value-oriented cooperation models.

The results of the present study also clearly call for a supply chain management which focuses not only on cost cutting but first and foremost on value creation. But though we’ve recently seen many steps in the right direction, this approach is still in its infancy. The automotive industry has pioneered the shaping of such value-oriented strategies. Methodologies developed there have set benchmarks for other branches in terms of innovation, flexibility, efficiency and process quality.

Being the leading provider of e-business solutions for the automotive and manufacturing industry our company itself is an integral part of global supplier networks. As such we are challenged to fulfil the transforming demands of the industry and to develop standardized tools and methodologies for effective collaboration. During the last years we have seen that collaboration between suppliers and their customers is getting closer and much more versatile. This scope of joint activities and the philosophy of mastering global challenges together have incrementally evolved over the years.

In the course of globalization and a decreasing company-internal value-add, the cooperation alongside the value chain will become more complex and an issue of great strategic importance. That’s why the industry needs a global supply chain management infrastructure based on generally accepted technological, process-related and compliance standards. The results of this study prove that worldwide leading companies clearly see the need for this development.

Markus Quicken
CEO SupplyOn AG
9. The Bottleneck – Qualification and Availability of Procurement Personnel

The numerous changes facing the organization of sourcing in the future highlight a clear need for action, particularly in terms of personnel. It is not only that the field is changing so rapidly, necessitating more and more new skills. The problem of lacking expertise is also due to the fact that the issue of “battle for talented people in procurement” was until recently not at the top of the highest level of corporate management’s agenda. The pressure to act has now become urgent: to the question “What percentage of your current procurement team members will not be able to deal with the future requirements of your global supply network by 2013?”, the survey respondents replied with an average of 22 percent. The pressure is particularly high in this respect in Africa and the Middle East (MENA) and in Western Europe (30 and 24 percent respectively). Broken down by industry, the telecommunications and manufacturing sectors are experiencing the most urgent need for action (25 and 24 percent respectively).

The urgent need for qualification and training is currently reaching budget-related limits: the further training demand in view of future requirements shows current investment in training of procurement personnel is not sufficient. A mere Euro 3,600 or 11 days per year and employee are available to procurement departments for further training. Exceptions are by far Western Europe (Euro 4,000 or 11 days), followed by North America. From an industry perspective, the banking and financial services (Euro 6,800) sectors and pharmaceuticals (Euro 6,400) stand out. Interestingly, the bankers burn up their budget in just 7 days – the lowest value across all the industries. Though Western European companies invest more than other companies in staff qualification, it is still not adequate in the face of future requirements.

In almost all sourcing markets, recruiting and retaining qualified personnel is a major challenge that will come to a head in the future. 86 percent of the
study participants believe that it will be more difficult in the future to attract high potentials with sourcing expertise in best value regions by 2013. NAFTA and Western Europe, though, will benefit from the structural advantages of developed training infrastructures – on these markets, the situation is less dramatic. However, the demand is high across the board. There are in fact disproportionately few dedicated study courses and institutes or chairs of learning for supply chain management, even in Germany, for example. At the same time, many teaching programs are either outdated, or undifferentiated and not specific enough to cover companies’ needs. This is the most important reason why the concept of the Corporate Procurement Academies is in more and more demand from companies nowadays. This cannot be sufficient long term, however: in-house programs need to be supplemented by an appropriate academic research and training landscape.

Ranking of regions by procurement personnel availability and retaining potential

Remark: Weighting 0 – 2.5; 2.5 being highest rank of personnel availability/retaining potential
10. Outlook – Paradigm Shift in Sourcing

The results of the survey clearly show that the low-cost approach that has prevailed for years is losing its significance and moving instead towards the BCCS, and increasingly the BVCS, approach. Macro-economic factors – made more acute by the current economic crisis – together with an increasingly differentiated outlook on the strategy are the drivers behind this development. They influence the decisions for or against sourcing outside the home region, as well as the choice of target regions.

**Major factors affecting the balance of sourcing between home and foreign markets**

- Growing local demand in emerging markets
- Rising energy prices
- Volatility of raw material prices
- Global aggregation
- Increasing competition
- Transportation costs accounting for greater portion of logistics costs
- Exchange rate fluctuation
- High importance: Economic situation
- High importance: Increasing labor costs
- High importance: Volatility of raw material prices
- High importance: Global aggregation
- Low importance: Trade barriers/tariffs
- Low importance: Transportation costs accounting for greater portion of logistics costs
- Low importance: Exchange rate fluctuation
- Low importance: Economic situation
- Low importance: Increasing labor costs
- Low importance: Volatility of raw material prices
- Low importance: Global aggregation
All in all – according to one of the central results of this study – global sourcing will continue to gain in importance with increasing focus on “local-for-local” approach. The rising logistics and transport costs, but also the growing demand on emerging markets, are responsible for this relatively new development. A further key factor is the protectionist tendencies that are felt all over the world, for instance in the form of trade barriers and tariffs that are aimed at boosting the depth of domestic value creation.

Change in strategic sourcing activities

- Increasing global supplier base: 31%
- No change in sourcing strategy: 24%
- Local-for-local: 34%
- Others: 11%

Source: BrainNet EAC Best Value Country Sourcing Survey 2008
The results also show, however, that sourcing activities in the future will take new, and in some cases not yet fully navigated, routes. Competitive pressure, changing economic structures and geo-political factors are shifting the emphasis on a global scale. From Western Europe’s perspective, these changes are particularly acute. The region will need to reposition itself in global terms. This is needed not only for the region to remain in the game in the future, as the hitherto most important procurement market, but also indispensable in order not to arrive too late on the booming markets of the next few years.

**Western European perspective on sourcing in 2008 versus 2013**

![Map showing sourcing trends](image-url)
This huge task is of course a major challenge for politicians. After all, the loss of procurement volume forecast above has a macro-economic impact. Legislators are being prompted to create legal, fiscal and infrastructural prior conditions that are appropriate for the regions’ global competition.

Yet primarily, these developments are a call for action on the part of the companies themselves. What are the most urgent tasks? The results identify six areas:

- Optimization of procurement management to reach a high level of transparency and supervision;
- Development of functional integrative procurement structures with broadened responsibility and a strategic approach;
- Global set-up of purchasing organizations to achieve best possible value/performance – staffing shift to future focus regions is necessary;
- “On time” optimization and systematic development of personnel training and qualification strategies in view of the future challenges facing international sourcing networks;
- Selective approach for a sustainable global sourcing model integrating both international and local elements;
- Development and implementation of the Best Value Country Sourcing approach to secure home market facilities.

These are the strategic imperatives of the next few years. With a change in philosophy towards sourcing, global market positions will be realigned – and over a significantly longer period than five years. Companies wanting to be part of this development – rather than onlookers – need to act, and now.
About BrainNet EAC GmbH

Leading CPOs are reaching the conclusion that global sourcing is about creating value in adaptive, global supply networks instead of just reducing costs. Therefore BrainNet has created its “Best Value Country Sourcing (BVCS)” approach. This approach combines best practices from more than 1,000 sourcing projects. Costs are only one of more than 20 key criteria’s (e.g., value creation potential, quality, green procurement, risks, CSR,…) which are covered by our holistic approach. This expertise can only be delivered based on a sustainable presence in the global key sourcing markets. Therefore BrainNet and Euro Asia Consulting (EAC) have combined their expertise in global sourcing in the form of a joint venture. The newly founded BrainNet EAC GmbH is an international leading Global Sourcing Consultancy with access to an unique infrastructure of branches in the world’s main procurement markets. Even before establishing the joint venture, the two companies ranked amongst the most prominent consultants for Supply Chain Management consultancy, Asia strategies and implementation projects. The newly founded BrainNet EAC GmbH is the world’s market leader with access to a unique infrastructure of branches in the world’s main procurement markets.

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