ASIA PERSPECTIVE

Asia Perspective Outlook: Sourcing Survey 2018

Will China Remain the Hub for Sourcing?

Uncover the trends in sourcing:
Regions, Channels and Organization

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About Us

Asia Perspective is an independent management consultancy with global presence and local knowledge. We assist our clients with business advisory regarding analysis, strategy and implementation. Our mission is to turn our clients' Asia business vision into reality and add significant value to their business.

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Executive Summary

As China moves away from being a manufacturing-driven economy to a more consumption and service-driven model, traditional sourcing activities in China will evolve into new dimensions and focuses. This transition is expected to pose new challenges to sourcing managers and industry professionals around the world.

In anticipation of these new challenges, Asia Perspective conducted a research project to understand the general consensus on how sourcing trends in China may change due to the transition.

The project is based on a survey sent out in April 2018 to over 1,000 executives and purchasing managers from over 30 different countries around the world.

At a Glance:

- Which are the main sourcing markets in the world and where does China stand?
- What are the main drivers for sourcing activities in China?
- What are the opportunities and threats associated with sourcing in China?
- How do international organizations set up to execute their sourcing activities in China?

The continuously growing supplier base, improved R&D capabilities, productivity gains and long-standing manufacturing experience are key reasons for China to remain as a favorite sourcing area in the world, despite the increasing production costs.

The study concludes that **Asia will remain the main global sourcing market with China playing a key role**.

The continuously growing supplier base in China, improved R&D capabilities, productivity gains and long-standing manufacturing experience are key reasons for the country to remain a favorite sourcing area in the world, even despite the increasing production costs.

Other Asian countries, especially India and Vietnam, are also expected to increase in importance as supply markets over the coming five-year period. Companies interested in sourcing from these markets in order to capitalize on the opportunities they present need to carefully plan, evaluate options and execute strategically to mitigate risks and manage the challenges.

Besides Asia, Eastern Europe was identified as an emerging key sourcing market to consider.

Some specific findings of the report are:

- The most significant reason for companies to source in China is cost savings due to the country´s large supply and labor markets. The second driving force to choose China is the availability and supply of components to be used globally for production of finished goods.

- The most important perceived risks are increasing purchasing cost, intellectual property risk and unstable supplier performance. These are consistent with the findings from the 2016 study.

- The most frequently used purchasing channel is direct purchasing, with a growing number of companies setting-up local subsidiaries in China to conduct purchasing activities.

- Purchasing organizations in China mainly follow a centralized or a hybrid centralized specific model. This trend reveals that companies want to balance their sourcing models to achieve synergies and flexibility at the same time.

- At an organizational level, successful organizations excel in aligning targets at different levels, in measuring performance extensively, and in involving both local staff and top management in their sourcing initiatives.

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1 Introduction

Over the last decade, worldwide sourcing has become a key success factor for building a sustainable competitive edge for global organizations. Factors such as increasing local production costs, efficient worldwide logistics and technological innovation such as Blockchain and IoT have made sourcing from emerging countries more feasible than ever before.

However, as emerging markets develop and the cost of living increases, typical low-cost production countries such as China are gradually losing their competitive advantages in terms of cost. International firms that seek low cost sources are affected by this trend and need to reconsider their global sourcing strategy for the future – should they switch to new sourcing markets such as India, Vietnam and Indonesia, or develop and consolidate their supplier base? After considering all switching costs, will they still realize a final cost-saving from the operation?

There is a consensus that pure cost consideration is giving way to other factors such as sustainability, logistical overhead, quality and services as key factors when making a sourcing decision. On one hand, this trend will make developed markets and near- shore locations more viable options again. Conversely, it also presents new opportunities for maturing sourcing markets once considered as low-cost regions, to turn its attention to innovation and value-added services. Clearly, as China moves up the value chain, it will face intensive competition from developed markets.

The combination of China's manufacturing infrastructure, along with supporting governmental initiatives, will continue to catapult China's dominance in the international procurement and supply chain realm.

Global sourcing, defined as managing internal customer demand across business units and geographic markets, is a daunting task, not only in terms of cost, quality and reliability, but also because of its role as a lever to drive top-line growth. Therefore, the purchasing function is rising in its importance in global organizations as more value-adding activities are being outsourced. Today, global sourcing plays an increasingly critical strategic role in the success of a business.

In the meantime, factors such as rising commodity prices, supplier viability and geopolitical concerns lead the myriad of risks that sourcing professionals face as supply chains stretch and change.

The combination of China's manufacturing infrastructure, along with supporting governmental initiatives, will continue to catapult China's dominance in the international procurement and supply chain realm.

Daniel Karlsson
Partner, Asia Perspective

2 Methodology

Asia Perspective conducted the survey in April 2018. The participants were asked about the following topics through an online questionnaire:

- Sourcing markets around the world
- Reasons and risks associated with sourcing in china
- Organizational setup
- Purchasing channels
- Cross-functional involvement
- Sourcing strategy
- IT systems

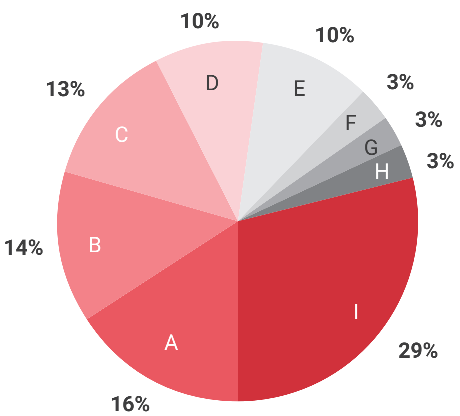
- Most participants are from the automotive, energy, natural resources, raw materials and retail industries.
- Over 31% of the survey's participating companies have a total purchasing value of over 100 million EUR per year. Only 9.2% of the respondents stated a total purchasing value of 5 million EUR per year or less.

Figure 1

Survey Participants by Industry and Purchasing Value

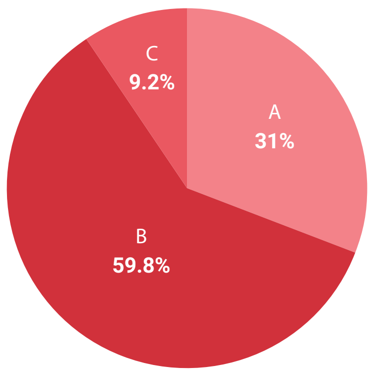
Which industries our respondents come from, and how large their purchasing spend is

Industry



A. Automotive
B. Energy/Resources/Material
C. Retail
D. Electronics
E. Machinery
F. Construction
G. Food & Beverage
H. Pharma/Chemical
I. Others

Purchasing Value



A. Over 100 Million Euro
B. 5-100 Million Euro
C. Less than 5 Million Euro

3 Sourcing Regions

Recently, global companies see sourcing strategy as a key component to their success. By expanding their horizons, companies are able to achieve a sustainable competitive advantage by reducing costs and increasing operational efficiency. It is, however, important to know where to locate sourcing activities.

By expanding their horizons, companies are able to achieve a sustainable competitive advantage by reducing costs and increasing operational efficiency.

This chapter will discuss the present and future status of sourcing markets from three distinct perspectives: global, national and regional. In the survey, the respondents answered questions on a five-grade scale.

The analysis is based on the respondents' input for year 2018 and their estimate for 2022.

For the country level analysis, respondents selected the 3 most influential sourcing countries today (2018) and in the future (2022). In addition, we asked our respondents what the key pull or push factors are that may drive a shift from one sourcing country to another in the future (2022). Finally, we asked about their current spend in China (2018) and their 3–year forecast.

3.1 A Global Perspective

The overview of the Global perspective is shown in Figure 2. The data shows that East Asia, Central Europe and South-East Asia are the top 3 sourcing regions in 2018 for the surveyed companies. In regards to future sourcing choices, East Asia is expected to remain a key sourcing region in 2022, but with a slight decrease in importance. The data also shows that companies expect their future sourcing activities to be in South-East Asia. The main reasons given for this trend are the optimization of international logistics, increasing shift to higher value-added production and the continued integration of the local manufacturing sites into global production networks.

Combining Figure 2 and Figure 3, we can see that South-East Asia, South Asia and Eastern Europe are the 3 key regions that will grow in importance as supply markets by 2022. In contrast, the Middle Eastern and African markets rated lowest as sourcing regions in 2018 mostly due to political instability, shortage of established industries and poor infrastructure. The overall status of these two regions as sourcing markets are not expected to change by 2022 even though the relative importance of Africa shows the highest growth over time.

South-East Asia, South Asia and Eastern Europe will grow in importance as key sourcing regions.

The importance of the Latin-American (including Central America) supplier market is not expected to change in the future according to the survey results.

Figure 2

Perceived Importance of Geographical Areas for Sourcing (2018 and 2022)

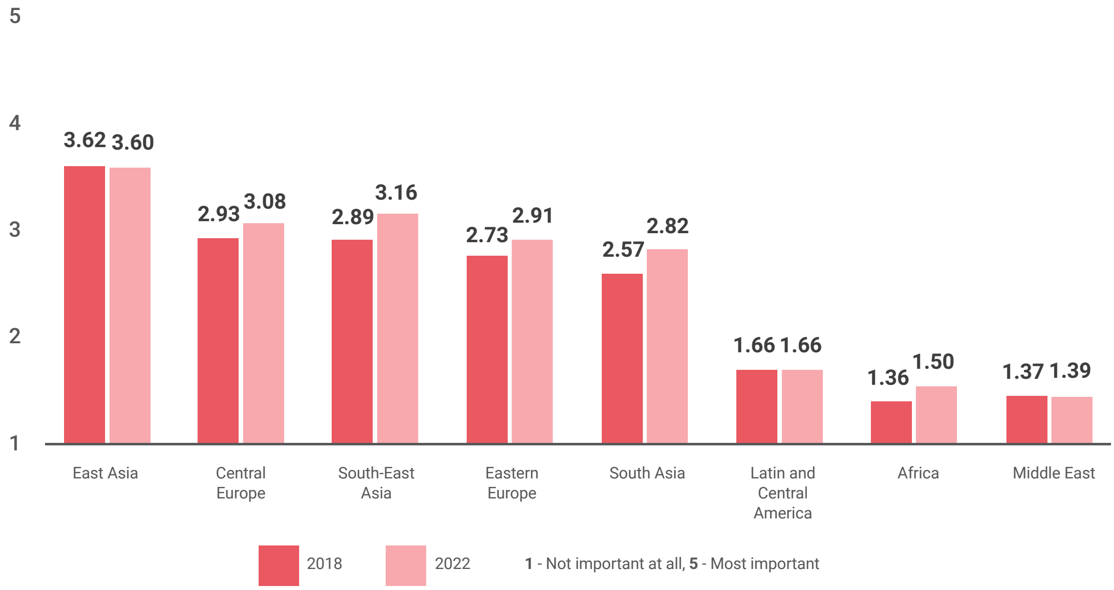
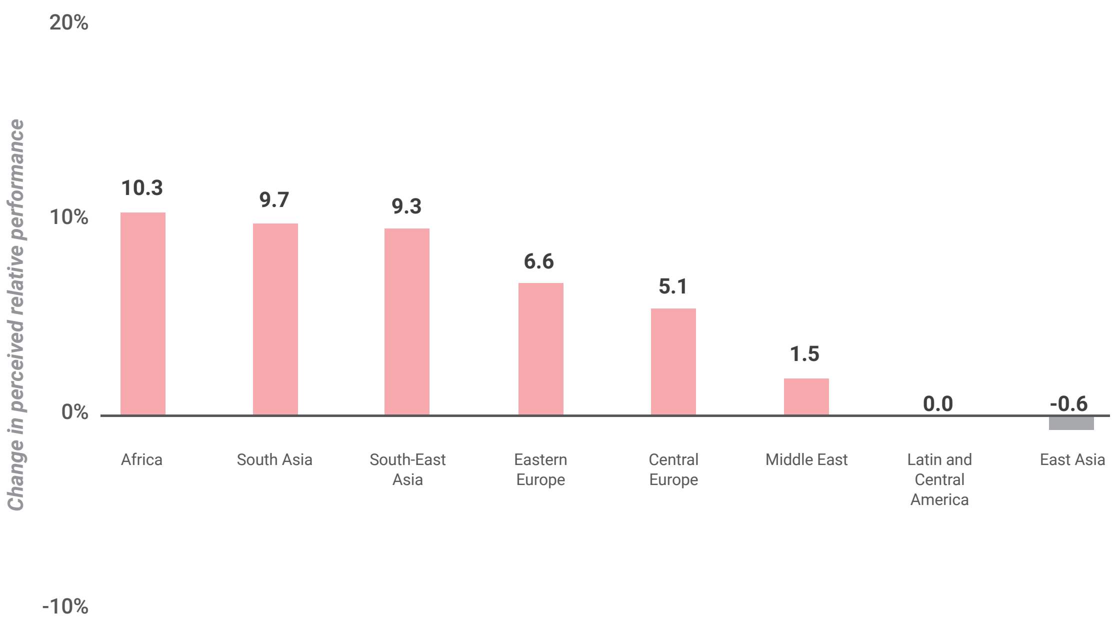


Figure 3

Change in Perceived Importance (2018 to 2022)



3.2 Country Perspective

In this section, participants were asked to name their top 3 sourcing countries now (2018) and how the selection may change in the future (2022). Figure 4 shows the countries mentioned most frequently.

The continuous development of political stability, improved economic conditions and better quality management will continue to strengthen the position of China as the world's preeminent country for sourcing.

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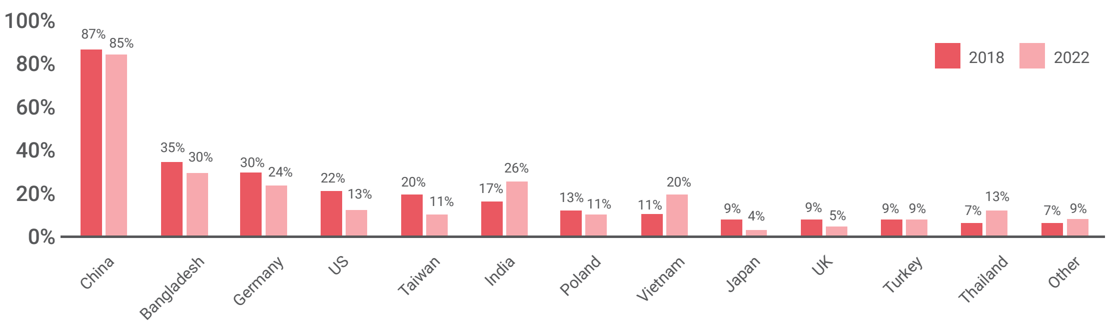
In terms of traditional export countries, Germany and the US were rated high by the respondents, but their sourcing importance is expected to decrease in 2022 due to various factors such as unstable trade policies. It can be concluded that sourcing will continue to shift from Europe and US towards Asia.

Figure 4 clearly shows that China is regarded as the most important sourcing market and is expected to maintain unchallenged at this position until 2022. This could be attributed to the growth of China's market size, improving R&D capabilities and long-standing manufacturing experience. In addition, China boasts a more stable political environment compared to other low-cost sourcing countries in the region. Eastern China together with other markets like Vietnam, Indonesia and India are seen as the best options for sourcing of low-technology or labor intensive industries (i.e. Textiles).

Figure 4

Sourcing Countries Perceived as Important

Share of respondents choosing each country among their top 3 most important sourcing regions in 2018, and the respective expectations for 2022



Southeast Asia is expected to increase their sourcing importance by 2022.

India, Vietnam and Thailand are all expected to increase their sourcing importance by 2022. Low labor and production costs together with continuous infrastructure improvements increase the appeal of these regions for sourcing activities. Vietnam, in particular, has been very successful at attracting multinational manufacturing companies in labor-intensive industries.

Japan and UK scored higher as sourcing regions compared to Thailand in 2018, but are expected to be less important by 2022.

Pull Factors

Figures 5 and 6 show the pull factors and push factors for switching sourcing countries in the future (2022). Figure 5 shows that 80% of our respondents selected sourcing countries based on their cost saving potential. Results also indicate that 58% of the respondents consider proximity to local production sites a key factor for choosing a sourcing region. Overall, the top 3 pull factors for a change of sourcing countries are cost, geographical proximity, and logistics.

Top 3 pull factors for changing sourcing regions are ***cost****,* ***geographical proximity*** *and* ***logistics****.*

Push Factors

As for push factors that can cause a shift in sourcing countries by 2022, the majority of the respondents (84%) said that their decisions to move sourcing away from a region is driven by cost increases. Cost is thus the primary deciding factor for purchasing managers.

Figure 5

Key pull factors for the shift in sourcing countries, 2018 - 2022

Share of respondents choosing each option as one of their top 3 pull factors

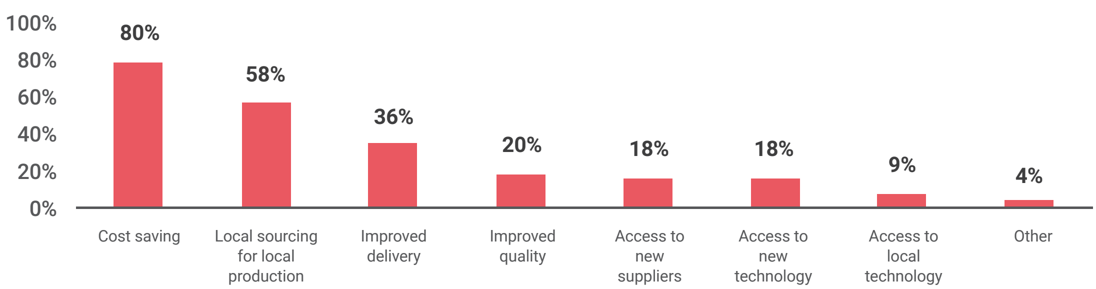
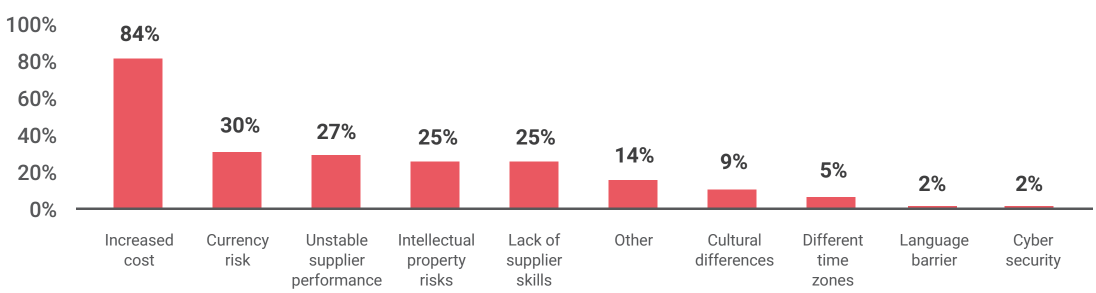


Figure 6

Key push factors for the shift in sourcing countries, 2018 - 2022

Share of respondents choosing each option as one of their top 3 push factors



Spend in China

82% of our participants indicated that they currently source from China. The study intends to further define the shifts in direct and indirect sourcing spend and potential drivers for these shifts. The percentages of direct and indirect spend in China by our respondents are shown in Figures 7 and 8.

Figure 7 shows that 36% of our respondents currently source more than 50% of their direct materials in China with a nearly equal 36.8% stating that they plan to allocate more than 50% of direct spend in China by 2022. This is confirming our previous finding that China will maintain its importance as a key region for manufacturing. Possible explanations include cost and logistics advantages as well as proximity to growing local markets.

We see an overall growth in indirect sourcing spend from global organizations. Those that are currently allocating the majority (over 70%) of their indirect sourcing spend in China indicated that they plan to significantly increase their spend by 2022. The survey results show the participants' confidence in China's economic restructuring of its manufacturing sector to higher value added.

Figure 7

Percentage of Direct Sourcing Spend in China, 2018 and 2022

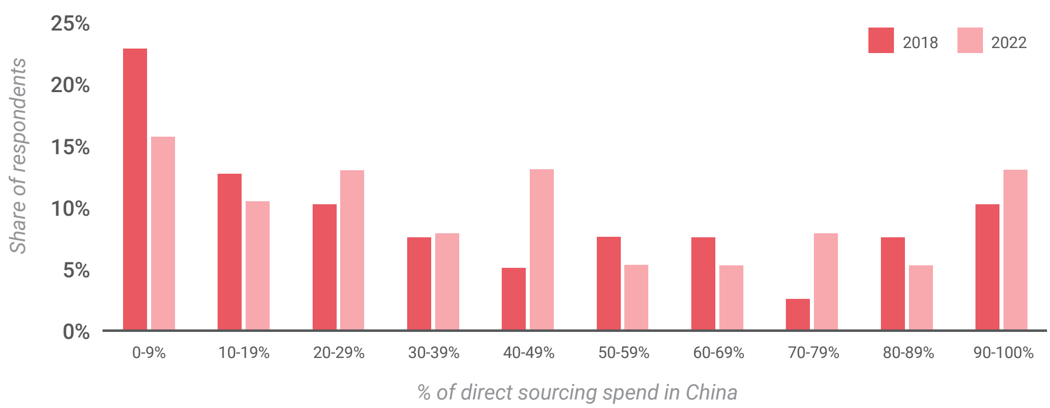
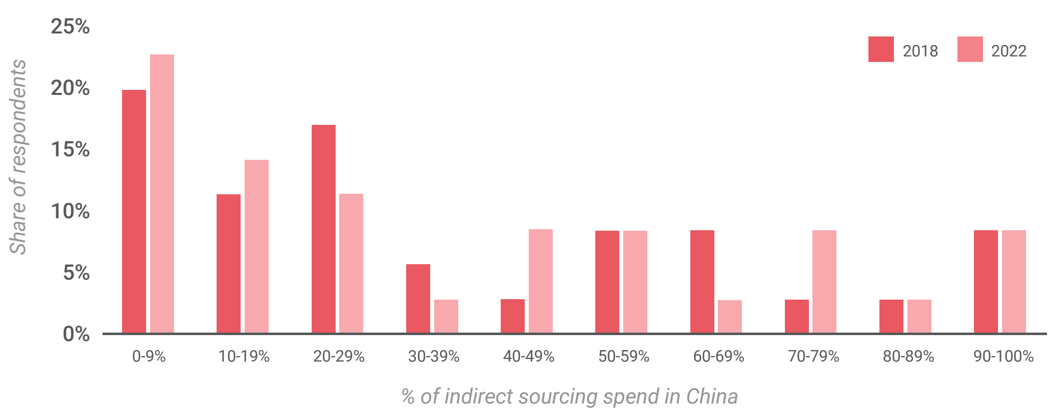


Figure 8

Percentage of Indirect Sourcing Spend in China, 2018 and 2022



3.3 China Regional Perspective

In summary, China will remain the leading sourcing market for the foreseeable future. However, it is also important to segment the country regionally to identify the best sourcing strategies. Figure 9 illustrates the importance of the different regions in China with the **Yangtze River Delta** (Shanghai, Hangzhou, Suzhou and Nanjing areas) and the **Pearl River Delta** as the top regions for suppliers. From a long term perspective, these regions will remain as key sourcing locations with well-established industries, large qualified labor forces and policy advantages in logistics and manufacturing.

Figure 9

Perceived Importance of Sourcing Regions in China, 2018 and 2022

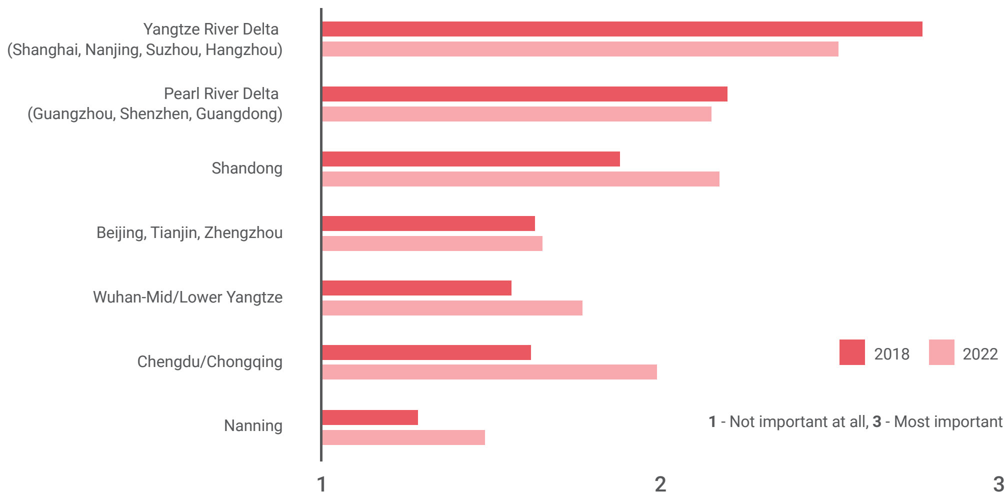


Figure 10 illustrates the expected regional change in the sourcing importance in the future. The importance of the areas around Chongqing, Nanning and Shandong will see a growth in 2022, a positive enforcement of China's "go west" strategy to boost economic development of 12 western provincial-level regions. The Yangtze and the Pearl River Delta areas will remain the key sourcing regions in China driven by major strategies such as the Belt and Road Initiative and development of the Yangtze River Economic Belt.

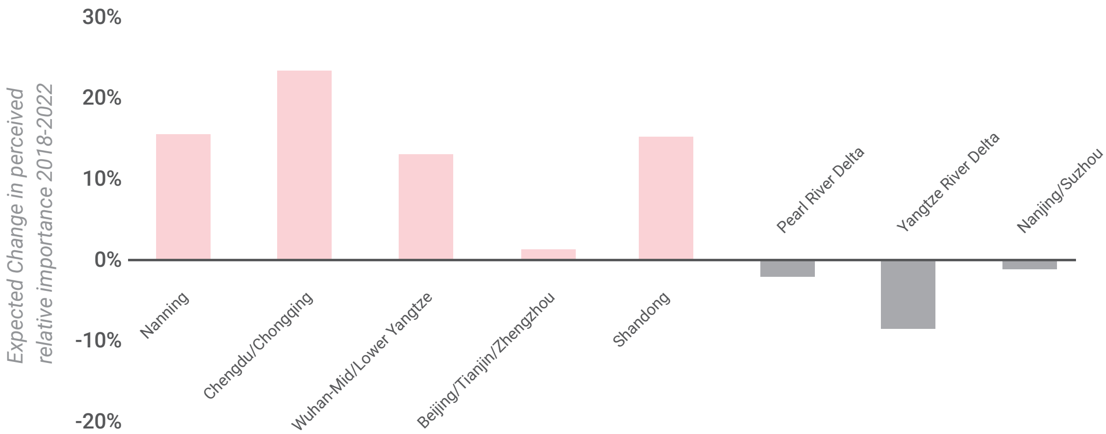
The gap between coastal and inland areas is expected to become smaller.

Nanjing and Suzhou are the main sourcing regions in the Yangtze River Delta, but these places are expected to be less significant in the future. The shift of sourcing regions indicates that the gap between coastal and inland areas is expected to become smaller. The Yangtze River Delta region is expected to decline in importance significantly in the coming six years, which was already projected in the 2016 study.

The shift away from the Yangtze and Pearl River Deltas will be caused by well-established industries with large qualified labor forces that will drive the increase of local direct material and labor costs in the future. Sourcing in inland China can bring benefits like lower labor and production cost, but there are also many inherit risks, not least complicated logistics.

Figure 10

Expected Change in Relative Importance of Sourcing Regions



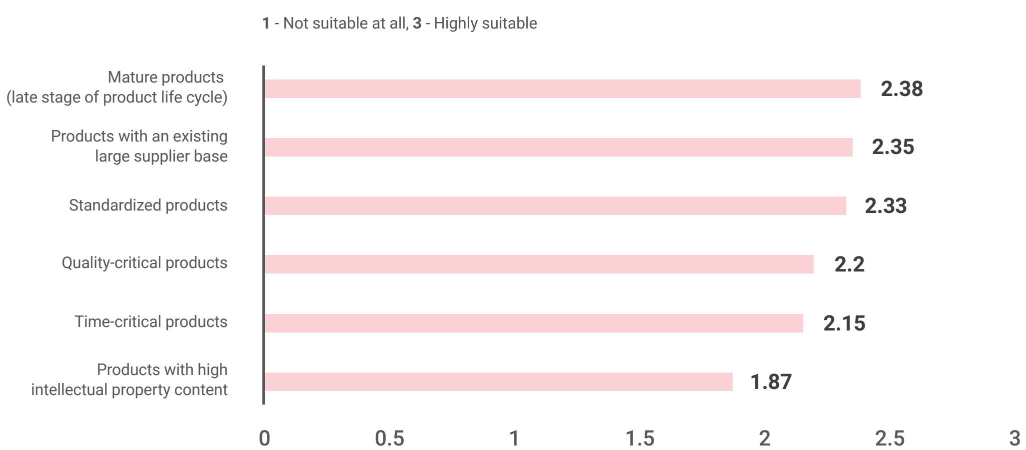
3.4 Sourcing the Right Supplies in China

China cannot be considered a one-stop-shop for all kinds of products. Although individual company technologies and competencies influence their ability to produce certain products, there are some common product features and characteristics that can be identified for products to be sourced advantageously from China.

The survey participants were asked to rate each product feature/characteristic as Not Suitable, No Impact or Suitable in China. The results are shown in Figure 11.

Figure 11

Suitability of Products for Sourcing in China



To ensure high performance in terms of cost, quality, and delivery, it is important to select carefully among potential suppliers. Not surprisingly, mature products with an already large, established supplier base are considered the most suitable for being sourced in China. An established local supplier base drives competition that results in more advantageous pricing and better quality. Companies find it both easier and less risky to cooperate with such suppliers.

On the same token, standardized and mature products, at the end of their product life cycles, often do not have high-tech nor high IP content, but the balance between cost and quality is critical. These products are easy to specify, speeding up the sourcing process, and have an established supplier market.

Products with an already large, established supplier base as well as standardized and mature products at the end of their product life cycles are most advantageous for sourcing in China while the suitability for sourcing time-critical products is on the rise.

Perhaps surprisingly, time-critical products were also considered to be increasingly suitable for sourcing in China. In our previous study five years ago, time-critical products were considered less suitable due to complex logistics and relatively low production reliability. The 2016 report showed that this perception was beginning to change. The results from this year's study show a significant increase in confidence on the predictability of lead times. This improvement is an effect of investments in logistics infrastructure, and of an increasing number of skilled laborers and better trained supply chain professionals.

Products with high IP content are deemed less suitable due to the weak IP regulation in the country, but their perceived suitability has been continuously increasing between each consecutive survey.

It is also important to note the increased suitability of sourcing quality-critical supplies from China. Since 2016, their perceived suitability has significantly increased. The quality and competency of Chinese manufacturers has been steadily improving and even surpassed the expectations from our previous survey.

4 Reasons, Risks and Channels for Sourcing in China

Based on the information presented so far, China is and will remain an important sourcing region.

To determine its real suitability as a supplier for a particular company, it is important to consider the detailed business requirements and the specific types of materials in question. There must be a match and synergy between the specific business and product requirements and the local conditions of the supplier market.

To analyze these issues, we will address them from 3 perspectives:

- Why do companies source from China?
- What are the perceived risks when sourcing from China?
- What are the main purchasing channels for sourcing from China?

4.1 Key Reasons for Sourcing in China

Figure 12 shows that low cost remains the key driver for companies' sourcing activities in China, with 78% selecting it as one of their top 3 reasons for sourcing in the country.

This result indicates that sourcing from China is widely perceived as a good option to achieve cost improvements. Even as production cost increases (especially affecting labor-intensive industries) and competition intensifies from lower cost countries, China is expected to remain a preferential country for sourcing. This is because China continues to offer a large supply of skilled labor at low cost, and a growing market of mature and efficient suppliers. All these factors are balancing out the potential cost gains associated with sourcing from less well-established sourcing regions.

Additionally, 54% of the respondents pointed out that they do "local sourcing for local production" as a key reason for sourcing in China. This suggests that many companies have already set up local production sites in China instead of only sourcing components to ship elsewhere for manufacturing or assembly, and more and more companies are planning to do so.

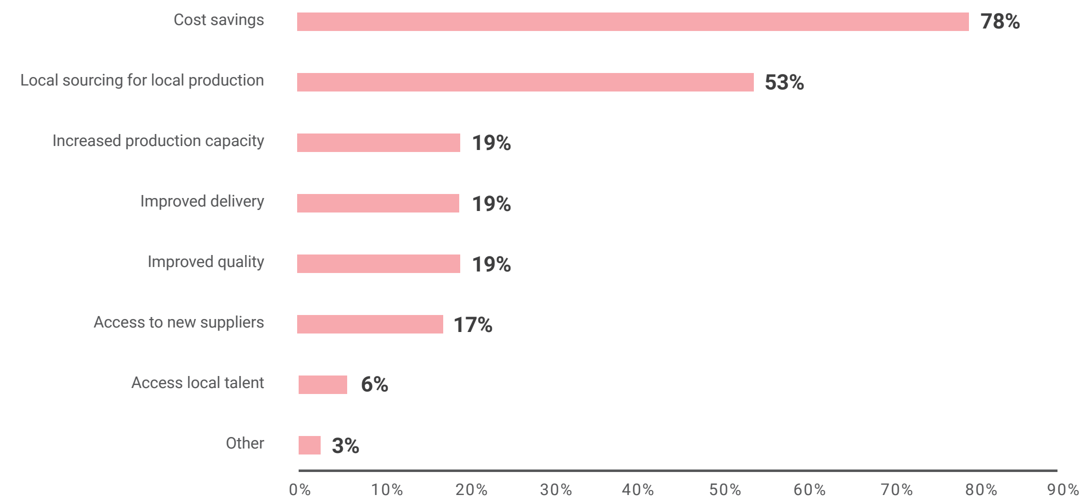
Key drivers for this development are the progress made in advanced manufacturing technology, the increased workforce competency and the growing domestic consumer market.

An increasingly skilled workforce and competent local management combined with the potential of China's domestic market are the key drivers for foreign companies to set up local production in China.

Figure 12

Reasons for Sourcing in China

Share of respondents choosing each option as one of their top 3 reasons for sourcing in China



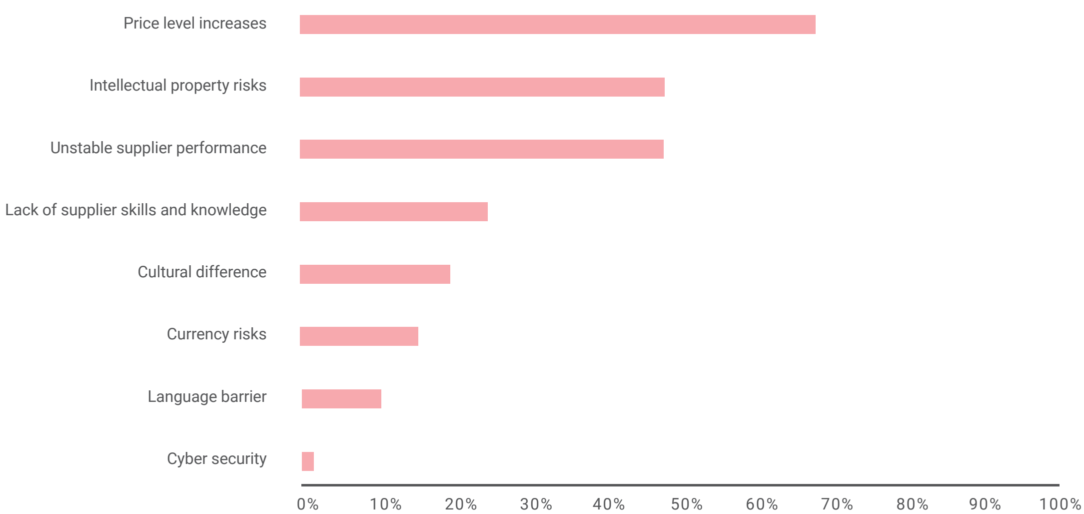
4.2 Key Risks when Sourcing in China

Despite the competitive advantages of sourcing in China, there are also risks and threats that need to be addressed. Operational risks, quality defects, economic sustainability and supplier reliability are some of the risks that may influence sourcing performance negatively. To mitigate these risks, it is important to first identify, define and assess the severity of the potential risk factors. The survey participants were asked to list their top 3 risks or threats when sourcing in China (Figure 13).

Figure 13

Key Risks when Sourcing in China

Share of respondents choosing each option as one of their top 3 reasons for sourcing in China



Based on results from previous surveys on this topic, the main perceived risk has changed, and the biggest concern nowadays is the increasing price level. Many companies source in China as a strategy to reduce costs, therefore, price increase is ranked as the biggest threat because it would defeat the purpose of sourcing in China to begin with.

Price Increase

Pricing in China is normally done using a cost-plus model and so maintaining a low cost of production is very important to keep pricing stable. The main factors that affect production cost include labor, quality, logistics and surveillance. All of these factors have inherit risks in China: labor costs are increasing as standards of living are rising, quality control require investment to improve process stability, supply chain costs require efficient inventory and logistics management, and finally, surveillance is a result of insufficient transparency, causing high expenses to monitor compliance.

IP infringement Risk

Another widely publicized risk of sourcing from China over the last few years is the risk of IP infringement. The main cause of this issue in China is not the lack of laws to protect intellectual property but the poor enforcement of these legislations. This is a real problem that affects China's position as a sourcing hub. Companies can mitigate this risk by measures such as manufacturing products with high IP content internally in wholly owned facilities or by strategically dividing components with sensitive IP content amongst several suppliers.

As China´s industries modernize, IP law enforcement is expected to improve with the increasing need for IP protection from local Chinese companies. Increased R&D investments and domestically developed IP is increasing the need for IP protection. This growing trend is rapidly transforming China into a competitive market for sourcing of tech products and services.

Currency Risk and Cultural Barrier

Finally, currency fluctuation and miscommunications due to language barriers are other potential risks from sourcing in China. Currency risks cannot be avoided completely, but well-informed companies can set-up risk management and contingency plans to mitigate the risks.

The language barrier can also be avoided by establishing local organizations and by providing relevant cultural and language training for the staff. If establishing a local team is not an option, then partnering with local agencies to represent your interests locally can also improve communication and prevent potential cultural issues.

4.3 Channels for Sourcing in China

A vital aspect of having a successful sourcing strategy in China is to choose the optimal purchasing channel. Participants in the survey were asked about the current channels they used for purchasing, and as Figure 14 illustrates, 74% responded that they established relationships with manufacturers and purchased directly from them. Purchasing directly from manufacturers can offer cost advantages by cutting additional margins in the value chain. In such a business model, supplier relations, quality control and compliance can, however, be challenging to manage.

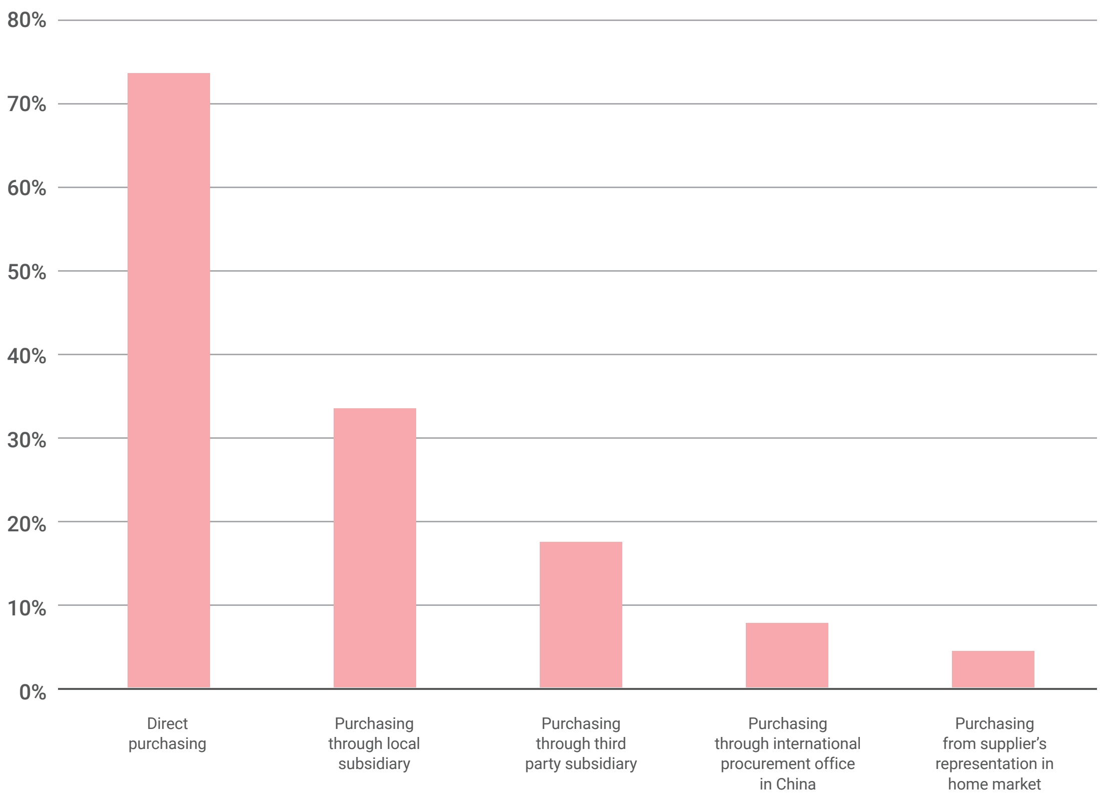
The second most popular channel for sourcing in China is purchasing through a local subsidiary (34%). This setup might require high investments, but simplifies collaboration and supplier management as all the relationships remain regional, eliminating a lot of the complexity in communication.

The third most frequently used channel is purchasing through third-party intermediaries, such as trade companies or agents. Although this is the less risky option, mark-ups on prices might sometimes offset the initial cost advantages.

Figure 14

Sourcing Channels

Share of respondents using the channel for all or parts of their sourcing



5 Sourcing Strategies and Operation

Benchmarking is an important tool for improvement. In this section, we will look at "what" and "how" companies set up their purchasing activities including organizational structure, IT system networks, platforms for cross-functional collaboration, continuous improvement actions and long-term vision for sourcing.

5.1 Organizational Structure for China Sourcing Activities

Setting up the right organizational structure is one of the most critical factors for successful sourcing in both China and elsewhere. Our participants were asked how they structured their local purchasing organizations with the following findings.

Centralized Model

In centralized organizations, critical decision-making is the responsibility of top managers at the global or regional headquarters. For sourcing in China, delegating the responsibility for purchasing actions to a few corporate managers with the necessary authority to negotiate deals holds both advantages and disadvantages. Centralized organizations have the potential to generate larger synergies and economies of scale, but the drawbacks are manifested in lower flexibility and decision-making speed. Figure 15 illustrates that centralized management models are still the most common.

Decentralized Model

On the other hand, the advantage of a decentralized model is that decision-making can be done at a lower level in the hierarchy and across different geographic regions. This increases the speed of decision making and moves it closer to the local markets.

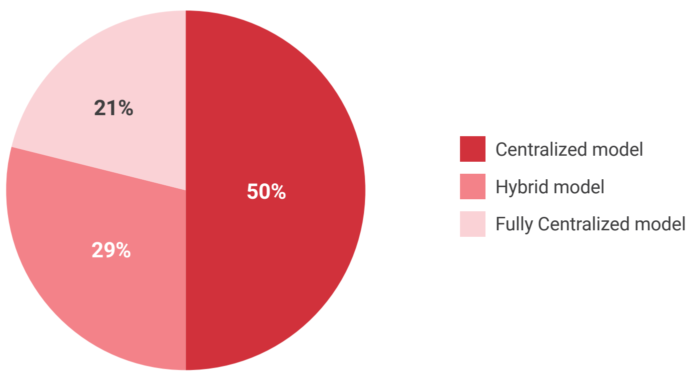
Hybrid Centralized Model

Using a hybrid centralized model helps overcome the disadvantages of the two first models, while amplifying the benefits of both. Since hybrid organizations will usually have two organizational dimensions (e.g. function and region), they enable better transparency and more thorough analysis during the decision-making process. A common problem with hybrid organizations, however, is that the dual reporting structure may cause internal conflicts, lack of accountability and slow down the decision-making process.

Figure 15

Sourcing Channels

Share of respondents using the organization model in their sourcing activities



5.2 IT Setup in China

IT systems are excellent tools that facilitate spend analysis, execution of the sourcing process, and supplier performance measurement, as well as many other parts of sourcing. Although IT tools will not solve any underlying problems, they offer management better visibility and enhance performance when properly set-up. In the survey, the respondents were asked to indicate which functional areas that were supported by the use of IT systems (Figure 16).

Figure 16

Sourcing Functions Supported by IT Systems

How frequently each function is supported by IT systems

From a company perspective, the larger the supplier base and the purchasing organization, the greater is the importance of the IT infrastructure. From Figure 16 we can observe that purchasing order management is most frequently supported by using IT tools: 72% of respondent's state that IT tools are utilized in this area. Payment management and logistics management come in the second and third place.

Most frequent IT-supported functions are operations-oriented and are not linked to supplier relationship management. These functions, e.g. supplier relationship management or contract management, are commonly done face-to-face in China, which might explain why around 65% of the respondents do not use IT tools in these areas.

5.3 Cross-Functional Collaboration

Effective cross-functional collaboration is required to keep different functions focused on the same objectives. Ensuring clear and efficient communication across departments, even those that are not involved in the process directly, will help optimize the overall supply chain. The continuous participation of all relevant functions will contribute to a better understanding of the requirements for raw materials, products and the business in general. The respondents were asked to list six functions that were involved in cross-functional cooperation with the sourcing teams.

Figure 17

Cross-Functional Co-Operation with the Sourcing team

The frequency of established cross-functional cooperation between each department type and the sourcing team

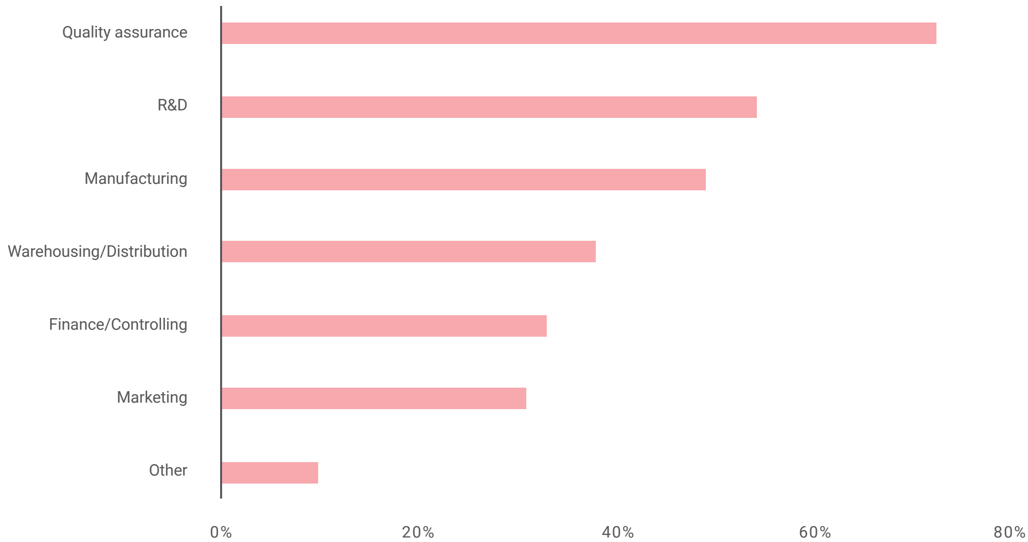


Figure 17 shows that the sourcing team has most interaction with Quality Assurance and R&D, which indicates that quality is still a key issue and therefore a focus area when cooperating with Chinese suppliers.

For short- to medium- term performance, the participation of production and distribution in the decision making process is highly desired. These departments have hands-on experience with material and products and can therefore give suggestions on how to optimize the supply chain as well as the product quality from a customer-focused perspective.

Comparing with the data from previous years, we see a declining trend in overall cooperation. This is however not true for marketing, which is increasingly involved in cross-functional collaboration with the sourcing teams. This could be an indication that sourcing has become a more stand-alone function as the capabilities within the local organizations develop, paired with improvement in overall quality of local suppliers. The upward trend in the cooperation with marketing could be a positive sign that sourcing organizations are more involved in pro-actively adapting the end products to the end costumers. In many cases, sourcing also turns to marketing as a measure to maintain and to build relationships with strategic suppliers.

A successful and effective sourcing strategy will have decisions made at the right levels in the organization. Our participants were asked to share "Who is responsible for what" and "at what level are the decisions made?"

For operational decisions, the decision-making authority is often delegated to the local sourcing team, to increase decision making speed. When operational decisions are made at a global level (centralized) the reaction speed of the organizations tend to be slower.

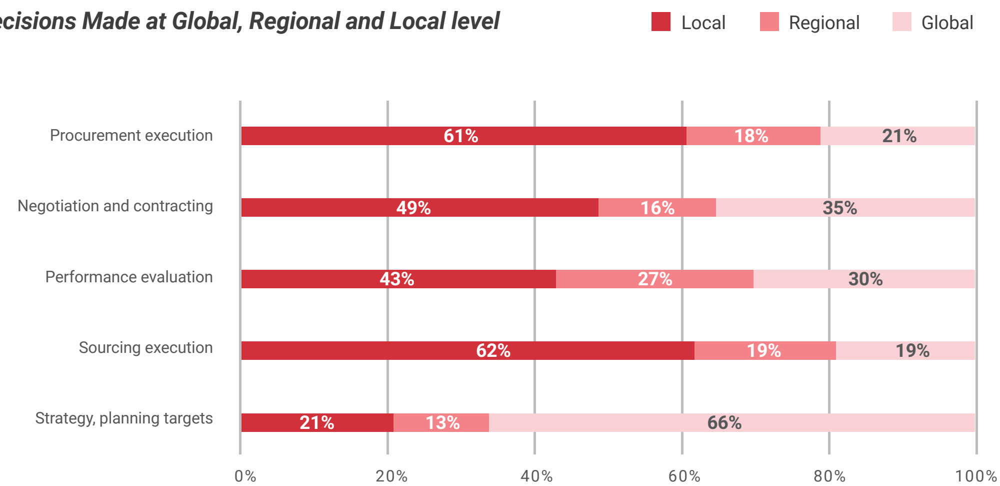
By having a clear reporting line and smooth information flow, decision-making can be decentralized to a regional level. As sourcing markets continuously change, local knowledge and decision-making speed grow increasingly important

By having a clear reporting line and smooth information-flow, decision-making can be decentralized to a regional level.

Conversely, higher level strategic decisions should be made by senior leadership to ensure buy-in and alignment across business units and functions.

Figure 18

Decisions Made at Global, Regional and Local level



Power delegation to the regional level increases flexibility, allowing higher responsiveness to market change.

Figure 18 shows that most companies try to structure their decision-making processes according to the concepts described above. Most of the surveyed companies make their operational decisions at a local level. Approximately 60% of procurement and sourcing decisions are made locally. To adapt better in a fast changing environment, more companies should delegate these decisions to local teams. On the other hand, 65% of the respondents claimed that they make strategic decisions, planning and target setting at global level.

Procurement execution is the only decision that is made more at a global level now compared to 2016. All the other decisions are now made more locally.

5.4 How to Improve China Sourcing Activities?

Continuous improvement is a key activity for any process and in this section we will analyze what actions can be taken to make sourcing in China more efficient. It is important to remember that less is often more. As resources are scarce, they should be invested in activities that are effective and where pay-off is larger. To uncover these drivers, we assessed the extent to which companies have undertaken improvement programs and what actions they plan to implement in the near future.

Benchmarking

In Figure 19 we see that 23% of the respondents used benchmarking in 2018 as an effective tool for identifying areas for improvement and for gaining a balanced view on current purchasing performance. 57% stated that their companies were planning to perform a benchmarking project in the coming five years.

Cost Management

The second most common planned measure is the implementation of a total cost management process. In total, only 13% of the companies have already implemented total cost management measures in 2018, but 46% of the companies were planning to implement such analysis in the next five years.

Building a Supplier Base

19% of respondents visited potential sourcing sites across China in 2018, and 31% were planning to do that in the next five years. This initiative is driven by the increasing purchasing costs and limited supplier base in certain areas such as advanced manufacturing and services. Continuous building and reviewing of the supplier base is necessary to maintain the competitiveness.

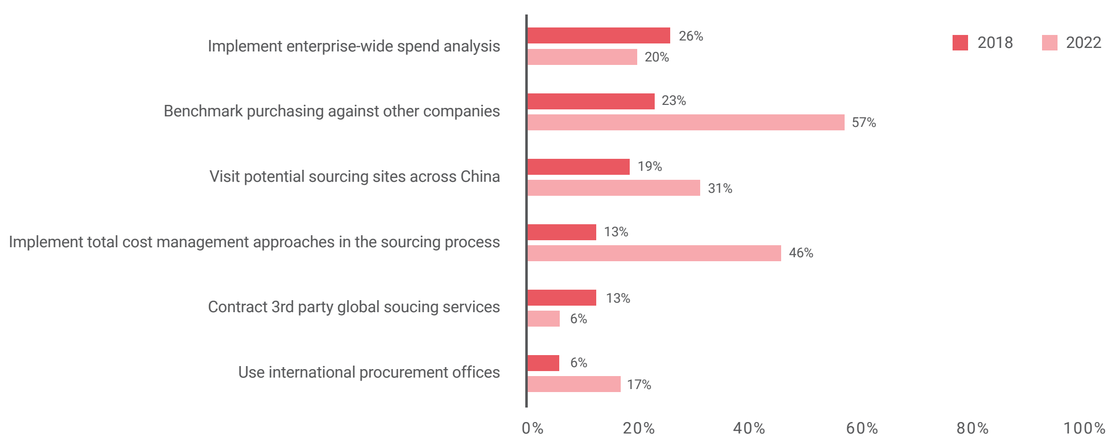
Spend Analysis

More than a quarter of all companies implemented enterprise-wide spend analysis in 2018. When considering planned actions for 2022, only 20% of all respondents claimed they will implement enterprise-wide spend analysis in the next five years, making it the activity that will decrease most in the coming years.

Figure 19

Actions Taken to Improve China Sourcing

Share of respondents that have implemented the action during 2018, and the share planning do so until 2022



5.5 Lessons from High Performers

What is it that makes leading sourcing organizations so great? We looked into our own internal benchmarking from leading sourcing organizations, and compared to data from the survey. These are our findings.

As can be seen in Figure 20, high performers commonly involve senior managers in local sourcing strategy development. This effectively ensures management buy-in and adequate resource allocation. Furthermore, high performers also articulate more extensive mission statements for their daily activities. Most importantly though, high performers align not only their goals but also their operations with high level corporate strategy.

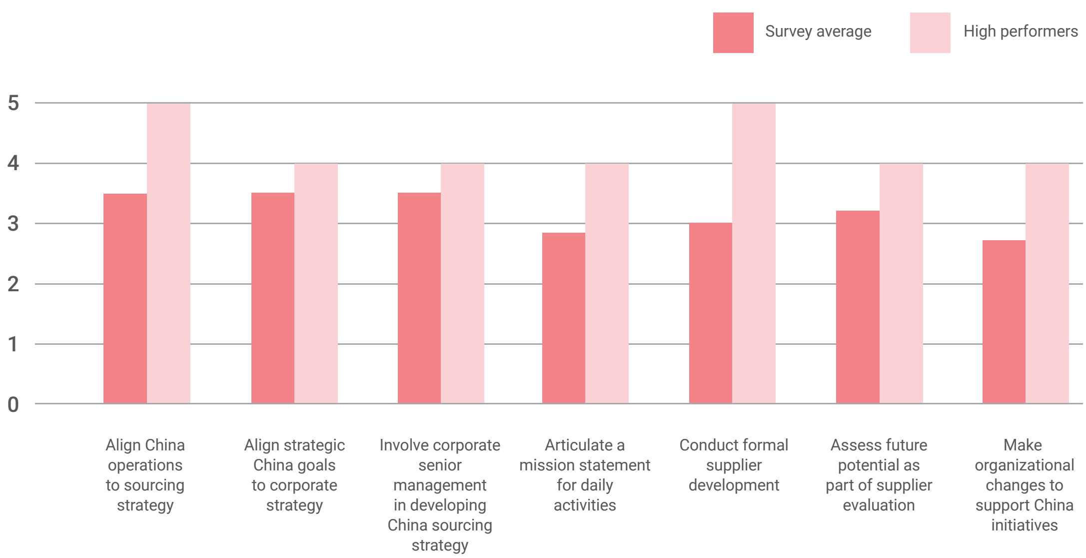
When initiating new supplier relationships, supplier performance is not always stable, especially in certain industries such as advanced engineering where gaps are often found between Western customers' expectations and Chinese suppliers' performance. Joint efforts from both sides are required to stabilize and continuously improve the performance of critical suppliers. High performing sourcing organizations tend to integrate sourcing strategy into the organization and make a continuous effort to support local supplier development.

The same strategies will not work in every region and high performers acknowledge this by adapting their strategies to local conditions in order to neutralize risks and exploit opportunities. The key to adaptation is a solid understanding of the local conditions of the country in question. At the same time, strategies should not only be localized to the specific regions but also aligned internally to the corporate strategy in order to maximize collaboration across the entities within the group.

Figure 20

What Distinguishes the Best

The respondents were asked to what extent the actions were fully implemented in their organization, on a scale from 1 to 5. We compared the results to data from previous benchmarkings of world leading sourcing organizations.



6 Conclusions

Companies have to expand their horizons to achieve sustainable competitive advantages. In order to generate the most value from their sourcing activities, it is important for companies to develop clear sourcing strategies with specific targets and plans. As global supply markets continuously change, it is essential that companies keep themselves up-to-date on both opportunities and threats in supplier markets, as well as continuously develop internal capabilities. This requires an array of strategic supply skills to be built in-house or obtained through third-party service providers. Companies that want to pursue global sourcing successfully must be equipped with the right organizational capabilities and tools in order to maximize effectiveness and avoid common pitfalls.

As illustrated in our study, emerging markets are expected to increase in importance over the next five-year period, at the expense of more mature markets. Companies have to revert to cost reduction as a strategy to increase profit and generate shareholder value. Even though emerging markets are experiencing increasing production costs, the potential consumer demand growth in these countries adds an extra incentive to move sourcing activities there. China remains the unchallenged leader among the emerging markets with a large domestic supplier base.

The research project results indicate that South-East Asia, South Asia and Eastern Europe are expected to increase their importance as supplier regions over the coming five-year period. Even though these regions do not currently have the same manufacturing capabilities as China, they are often very attractive for services (e.g. India and The Philippines for call center operations) and low-tech and labor intensive industries (e.g. Vietnam for textile products and electronics). Our respondents have high expectations for India, Vietnam, and Indonesia as future sourcing markets, mainly due to their lower labor costs and improving infrastructure. In particular, the ASEAN region has a very large growth potential and is growing as a global hub for manufacturing and trade - rapidly developing into one of the largest economic zones in the world.

An in-depth review of China reveals that the Yangtze River Delta region remains the most attractive region, although it is predicted to drop slightly in relative importance by 2022. The Pearl River Delta is also predicted to decrease in importance by 2022. On the other hand, the inland cities of Chengdu, Chongqing, and Wuhan will increase in importance by 2022. Although Chongqing and Chengdu might not be ideal locations from a logistics perspective, the fast-growing local market and the increasing government investments in infrastructure are continuously improving the attractiveness.

The study concluded that cost savings are still the key reason for sourcing in China, although other factors are rapidly gaining in importance. It is logical then, that price increases are perceived as the main risk associated with doing business there. In many cases, companies react to increases in sourcing costs by considering relocating the sourcing activities. It is, however, important to consider that costs associated with re-sourcing might offset cost reductions. A total cost view, that includes transportation, warehousing, and cost of compliance is important to consider before making these types of decisions.

The well-documented risk of IP infringement is decreasing, but will remain significant in the foreseeable future. Unstable supplier performance, previously a major issue, is also perceived as less of a risk now and expected to decrease further over the coming five years.

In terms of suitability of supplies being sourced, the pattern hasn't changed much over time: supplies from an already large, established supplier base is considered the most suitable for being sourced in China, followed by supplies of mature products and standardized products.

Finally, the study also reveals the key factors that distinguish high-performers from average performers. At a strategic level, high-performers align their strategic China goals to corporate goals. They involve senior management, align operations to strategy, and articulate a mission statement for sourcing activities more extensively than average performers. In addition, high-performers not only monitor internal operations, but also evaluate the external environment for opportunities and risks. Apart from that, they make flexible changes when required, such as organizational restructuring to effectively support China operations.

In conclusion, China is and will remain the world's leading sourcing market. The key for companies to source successfully in this market, is that they need to plan, evaluate and execute strategical actions, all while managing the challenges and risks, and capitalizing on the opportunities.

Thanks

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