



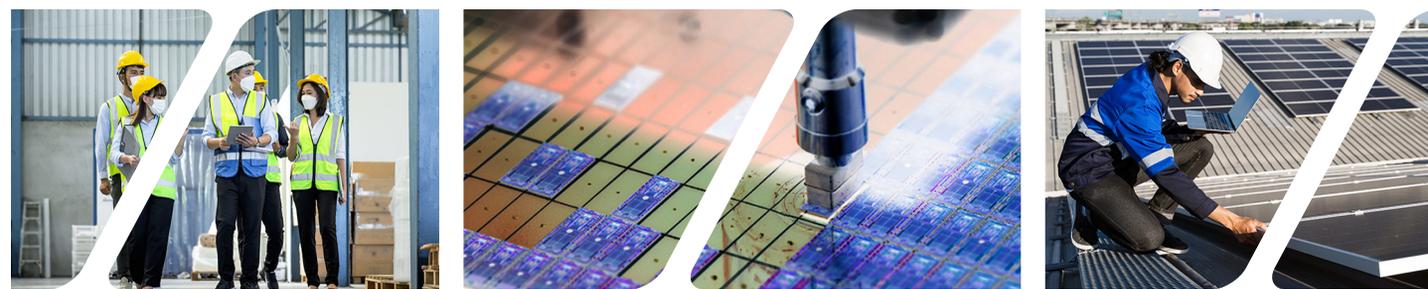
**ARC Consulting:** Sourcing Survey 2023

# After the Storm

**Uncovering the trends in sourcing:**

Experiences and outlook on how companies view their global sourcing and supply chains.

[www.arc-group.com](http://www.arc-group.com)



# About Us

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**ARC Consulting is the most trusted and well-recognized partner and service provider for European companies in Asia.**

We are specialized in bridging the business ecosystems of Europe, East Asia, and Southeast Asia. Our services cover market entry and growth, operational setup and reorganization, ESG, production, and sourcing, as well as cross-border M&A and financing.

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## Our expertise



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# Executive Summary

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ARC Consulting, formerly known as Asia Perspective, has been conducting sourcing surveys annually since 2013. These surveys aim to gather opinions and perspectives on global sourcing activities and how they have evolved. The research is based on a survey distributed to over 1,000 executives and purchasing managers worldwide, reflecting changing attitudes and beliefs rather than quantifiable sourcing changes, for which there is already ample data. The purpose of this report is to provide insight into future trends by measuring intangible changes in perception that often precede tangible pattern shifts.

During 2023, global supply chains began to recover after a tumultuous period that was marked by the pandemic and conflicts, especially disruptions at the start of the War in Ukraine. As China reopened, businesses resumed their sourcing activities in the country. Nevertheless, the return to pre-pandemic levels is not complete, and the trend of sourcing from alternative locations in Europe and Southeast Asia persists. The return of sourcing to China exists side-by-side with the trend of sourcing from alternative locations due to the ongoing trade tension at a political level.

Additionally, supply chain sustainability has become a major concern for both consumers and governments, compelling businesses to give more attention to this issue.

The study seeks to shed light on the extent companies are relocating sourcing activities, where they are choosing to move, and what factors are motivating their decisions. In addition, the study also tries to answer the degree that companies are monitoring and ensuring the sustainability performance of their supply chains.

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## The Study at a Glance:

- What is the current sourcing situation in China, Southeast Asia, and Europe?
  - Are companies reshoring/nearshoring and where are companies relocating to?
  - What are the perceived risks and underlying reasons companies are looking at alternative sourcing markets?
  - What are the risks and benefits associated with sourcing in China, Southeast Asia, and Europe?
  - To what extent are companies monitoring and assessing their suppliers' data on carbon footprint, fair labor, and corporate integrity within the environmental, social, and governance (ESG) sustainability framework?
  - What methods are companies using to ensure their supply chains' sustainability and what are their reasons for doing so?
  - Which will be the most important sourcing countries and regions in the future?
-

*Alternative sourcing  
from Europe and  
Southeast Asia persists,  
existing side-by-side  
with the return of  
sourcing from China.*

This year's study highlights the recovery of sourcing activities in China after three tumultuous years as China decided to ease COVID-19 restrictions at the end of 2022. Indeed, the country's complex and experienced manufacturing base proves its enduring appeal to many companies. At the same time, however, the study also shows that Southeast Asia and Europe are gaining appeal as an alternative to China.

As a whole, each sourcing market presents its risks and benefits. There is no ultimate answer to which market is the best, and the key to a successful sourcing strategy is to gather comprehensive data from each market, evaluate one's demand and requirements, and choose the strategies most suitable for the company's specific needs.

### **Some key findings of the report are:**

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- China remains a key sourcing market, yet about 30% of respondents indicated plans to relocate at least parts of their sourcing within the upcoming year. Nevertheless, few other markets offer the same competitiveness, and many companies are staying in the country as of now.
  - In the future, Southeast Asia and Europe are expected to be considered China's equals when companies are choosing sourcing locations.
  - The key reasons companies are looking at alternative sourcing markets include cost savings, improved logistics, distribution capabilities, and risk mitigation. The main barriers companies face when entering new markets include quality risks, insufficient knowledge, and production capability risks.
  - Companies are more likely to obtain and assess data regarding fair labor and corporate integrity than carbon footprint, pointing to a lack of awareness toward sustainability metrics that are not immediately and visibly urgent.
  - Companies prefer more hands-on methods (e.g. factory visits and third-party audits) than using other media reports for assessing the suppliers' sustainability performance.
  - Companies' primary motivations for assessing the suppliers' sustainability performance includes avoiding legal sanctions and alienation of customers.
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# Table of Contents

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- 1** Introduction ..... 6
- 2** Methodology ..... 7
- 3** Sourcing markets overview ..... 9
- 4** Relocating trends ..... 16
- 5** The role of ESG in sourcing ..... 27
- 6** Future of sourcing ..... 34
- 7** Conclusion ..... 38

# 1 Introduction

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From 2020 to 2022, global supply chains were deeply impacted by the COVID-19 pandemic and the War in Ukraine. Firstly, COVID-19 lockdowns significantly hampered the movement of goods and services worldwide, with major sourcing markets like China forced to quarantine some of their largest manufacturing centers. After COVID-19 subsided in 2022, conflicts flared up in Europe. After three tumultuous years, 2023 and beyond are expected to be the time of returning to normalcy.

The easing of COVID-19 restrictions in China that started at the end of 2022 has helped the country regain some of its former attractiveness as a sourcing destination. As a result, more companies have resumed their sourcing activities in the country. This follows a slump between 2020 and 2022 due to China's lockdowns of major manufacturing hubs such as Shanghai and Xian. This development demonstrates China's continued attractiveness as the world's foremost sourcing market thanks to its extensive existing manufacturing ecosystem.

Be that as it may, the recovery of sourcing activities in China does not erase the movement toward Southeast Asia and Europe as alternate sourcing markets that were underway even before the onset of COVID-19. The disruptions between 2020 and 2022 have highlighted the need of developing alternative markets to that of China to avoid overreliance on one sourcing market. The rising tension between the US and China has made the diversification of sourcing markets even more crucial to mitigate possible adverse developments. Finally, the gradual movement of business from China to alternative markets since 2018, the start of the US-China Trade War, has given many companies and the business world, in general, some experience to deal with the initial hurdles of relocating.

Two of the most prominent alternative locations include Southeast Asia and Europe. The former is because of its proximity to China as well as affordable labor and operational cost. Europe, meanwhile, offers a major manufacturing base and a stronger rule of law. Overall, despite the rise of these two markets, they have not been able to displace China as the world's top sourcing destination due to the country's much more sophisticated manufacturing base.

Furthermore, customers' and governments' concern about supply chain sustainability has been on the rise. For a multinational company's supply chain, sustainability is mostly manifested in the degree of carbon footprint (environment), working conditions (social), and corporate integrity (corporate governance), or ESG practices, of its suppliers.

Concern about ESG is also a response to changing consumers', employees' and financial investors' sentiments. As a consequence, companies now have to pay more attention to the impacts of their operations on the environment and human rights.

2023 is the year when global supply chains started to recover. However, the year is not simply a return to the status quo, but also a time when major changes are underway that can upend global supply chains for years to come.



Daniel Karlsson  
Managing Director, ARC Consulting

# 2 Methodology

The survey was conducted by ARC Consulting in the summer of 2023. The data was collected through an online questionnaire consisting of 60 questions, covering the following topics:

- Sourcing markets overview in China, Europe, and Southeast Asia
- Current reshoring/nearshoring activities and trends
- The role of ESG in sourcing
- The future of sourcing and the perceived importance of different sourcing regions

The majority of the survey participants are located in Asia and Europe. Most are operating in the manufacturing, retail, electronics, machinery, or automotive industry. Over 31% of the survey respondents have a purchasing value of over 100 million USD per year.

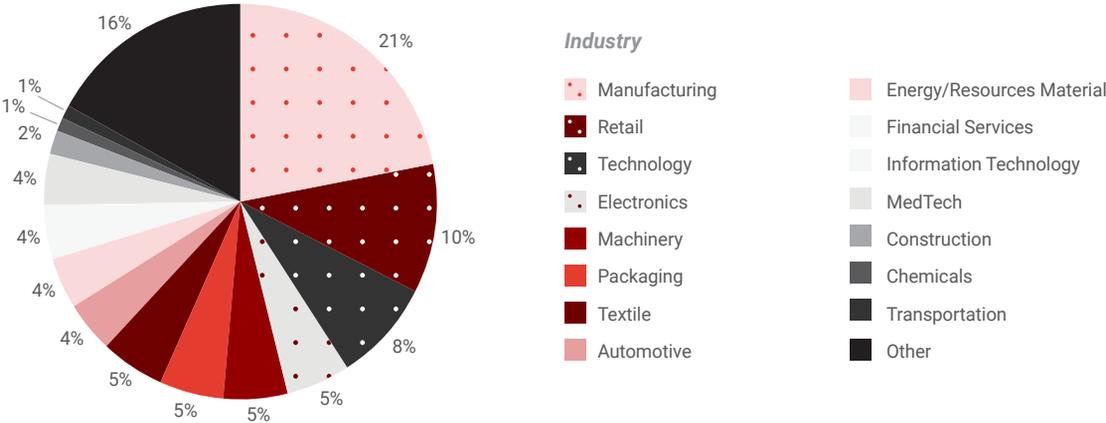
**Figure 1**  
**Survey participants by location**

*The geographical locations of the surveyed companies' headquarters*



**Figure 2**  
**Survey participants by industry**

*Share of the respondents belonging to different industries*

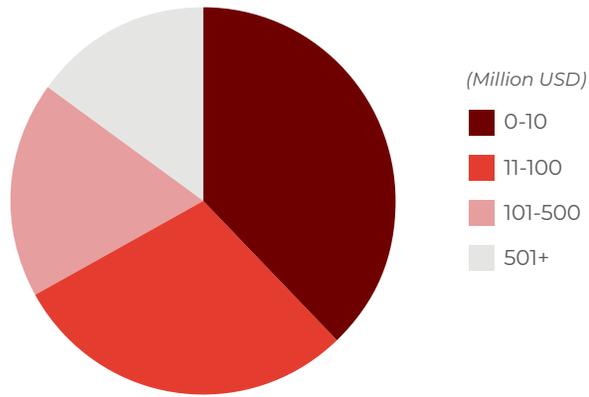


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**Figure 3**

**Total global purchasing amount in 2023 (Million USD)**

Share of companies belonging to different classes of total global purchasing amounts in 2023



### 3 Sourcing markets overview

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In recent years, disruptions to supply chain operations occurred frequently, due to rising costs, environmental issues, intensifying geopolitical risks, and production suspension. Although global supply chains have gone through the pandemic and are recovering from the headwinds from 2020 to 2022, global supply chains remain fragile. Companies now continue to diversify their supply chains while rethinking and improving their sourcing strategies to mitigate risks and lower costs.

*Companies continue to drive reshoring/nearshoring in global supply chains while rethinking and improving their sourcing strategies.*

This chapter illustrates the survey respondents' current sourcing situation in China, Europe, and Southeast Asia. To identify sourcing trends and shifts, the responses are compared with the result of previous surveys when data is available.

This chapter seeks to answer the following questions:

- What are the current sourcing situations in China, Europe, and Southeast Asia?
- What are the shares of purchasing spend in China, Europe, and Southeast Asia?
- What are the reasons companies source from China, Europe, and Southeast Asia?

#### 3.1 Current sourcing situation in China

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Three years of COVID lockdowns have disrupted global supply chains as well as international trade and investment between China and other countries. Although the Chinese government abruptly abandoned its Zero-COVID policy at the end of 2022, there are many other concerns in China as a sourcing market.

**Figure 4**

**Current sourcing in China compared to the previous four years**

*Share of respondents who source in China*

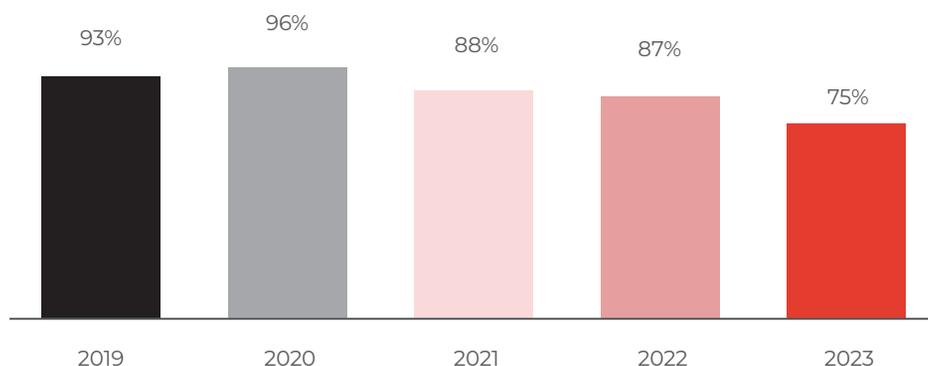
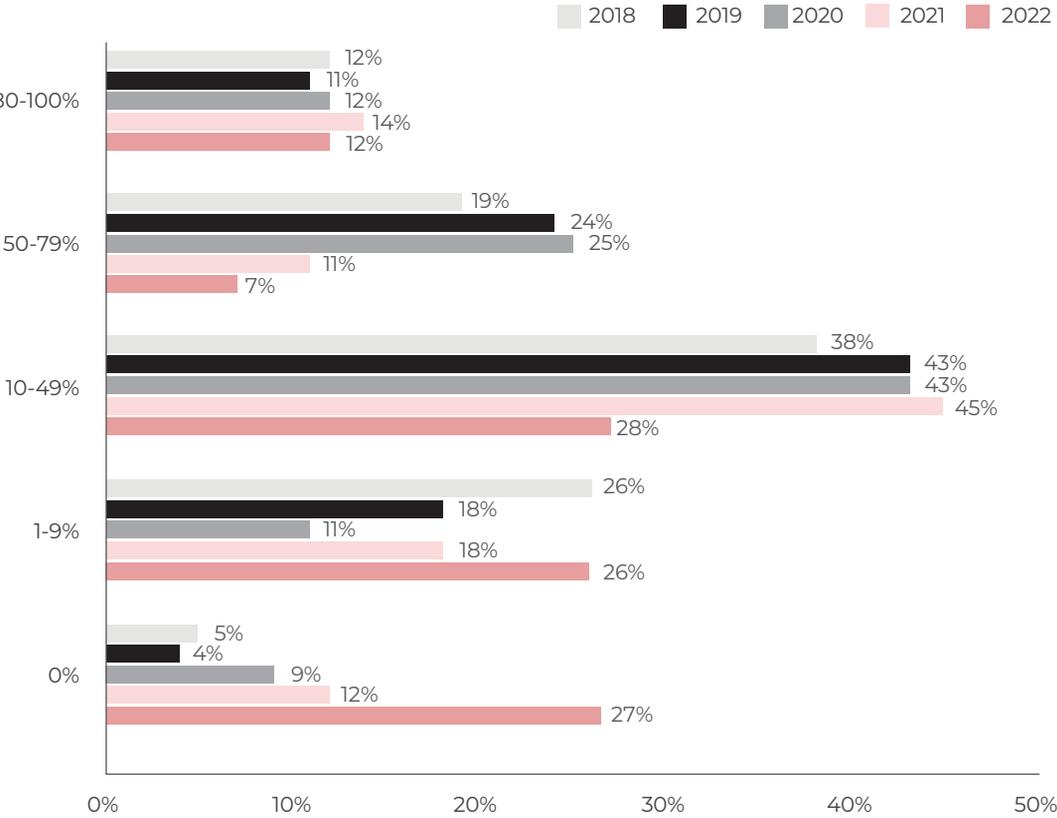


Figure 5

**Purchasing amount in China as a percentage of global purchasing spending in 2022**

Estimation of how large the purchase amount was in China compared to the global purchasing spend in 2022

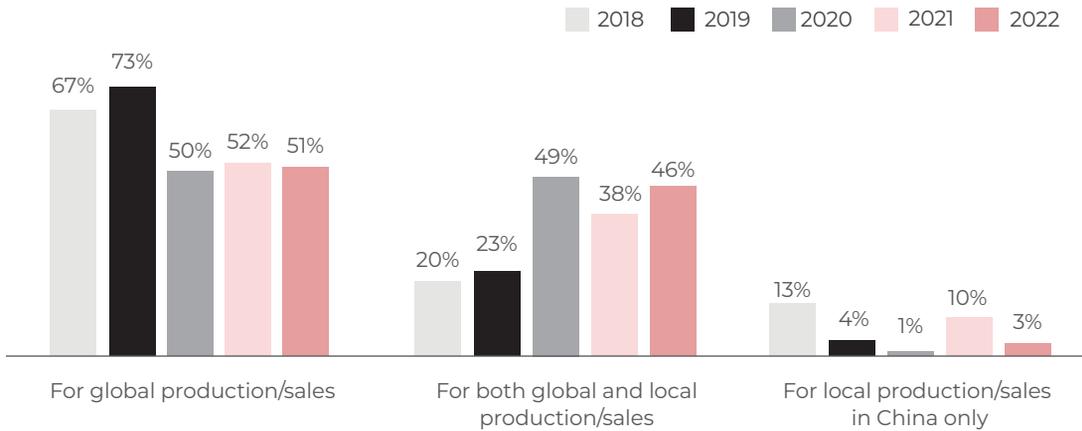


The survey shows that only 75% of the respondents sourced from China in 2022, a notable decrease over the past three years after peaking at 96% in 2020. According to Figure 5, half of the respondents sourced less than 10% of their global purchasing spend from China, increasing significantly by 60% from 2021. More specifically, a sharp increase, from 12% to 27%, can be seen in the responses that stated no current sourcing in China. When looking into the range from 80% to 100%, the share has remained relatively stable during the surveyed period. What can be speculated is that companies that heavily, or even entirely, rely on sourcing from China, tend to maintain the current strategy. Although China still occupies an essential role in global supply chains, the survey data also reveals that global companies plan to reduce purchasing in China and at least in part bring sourcing to other countries.

**Figure 6**

**Reason for sourcing in China – to serve local demand or for global supply**

Share of respondents choosing the alternative as their main reason for sourcing in China



Most respondents recognize that China is mainly a market for their global supply, with 51% of the respondents sourced in China. However, as the data gap between pre- and post-pandemic suggested, the Chinese market has become less important for companies' global sourcing needs. Noticeably, this year, only 3% of respondents considered China solely for serving local demand, down 70% from 2021. There is no doubt that the Chinese market is still competitive and has remained an important sourcing hub for various sectors and industries and that it will retain this status in the foreseeable future. However, the data also indicates that it has been increasingly common for companies to at least shift parts of their sourcing activities to decrease their dependence on China as their primary global supplier.

### 3.2 Current sourcing situation in Europe

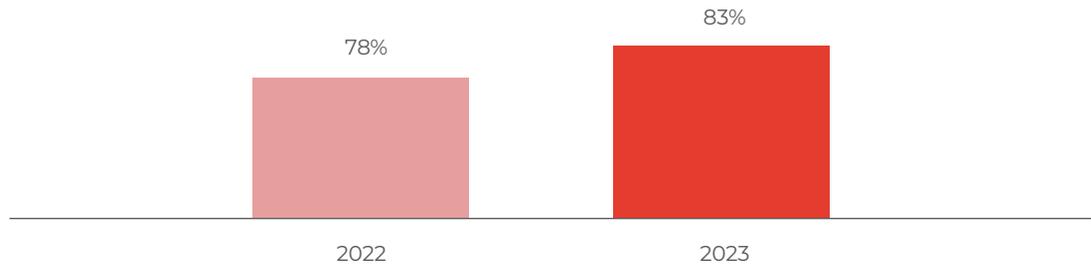
When companies diversify their sourcing destinations, considering factors such as ESG issues, lead time, and product quality, increasingly European companies are encouraged to look at markets outside of Asia, closer to home, despite the cost advantage, proximity to China, and preferential policies in tariffs and trade in Southeast Asia.

With the increasing predilection for sourcing closer to home, ARC Consulting examined companies' sourcing activities in Europe. The results will help improve the understanding of companies' perceptions of the market while detecting reshoring/nearshoring trends and shifts in global supply chains.

**Figure 7**

**Current sourcing in Europe**

Share of respondents sourcing in Europe

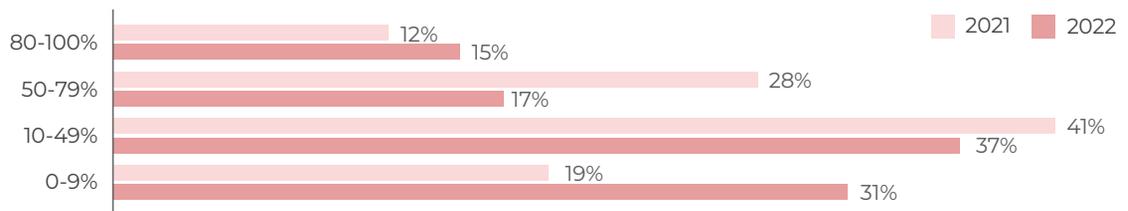


According to Figure 7, 83% of the surveyed companies are already sourcing in Europe, a number that increased by 5 percentage points from 2022 and exceeded the recorded number in China during the same period.

**Figure 8**

**Share of purchasing amount in Europe of global purchasing spend in 2022**

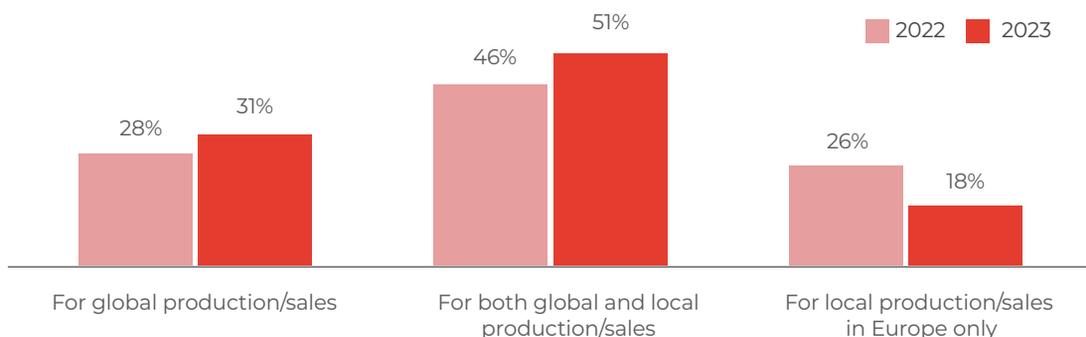
Estimation of how large the purchasing amount was in Europe compared to the global purchasing spend in 2021 and 2022



**Figure 9**

**Reason for sourcing in Europe – to serve local demand or for global supply**

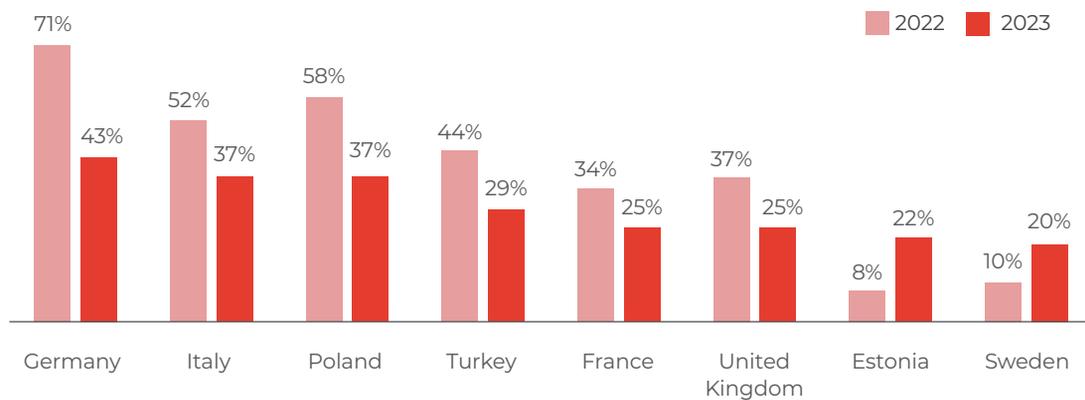
Share of the respondents' choosing the alternative as their main reason for sourcing in Europe



Compared with China which served mainly to meet global production demand, as illustrated in Figure 9 Europe is also the main destination where their purchased materials are consumed. However, this tendency becomes less distinctive than last year. Figure 8 illustrated that among the respondents who are sourcing from Europe, 31% of them stated that they spent between 0% - 9% of their global purchasing value in Europe in 2022, which increased significantly when compared with 2021 while the notable decrease can be seen in the 50%-79% section. The shift may be related to the energy crisis in Europe this year, pushing many manufacturing companies to reduce their investment as a means to decrease risk.

**Figure 10**  
**Sourcing locations in Europe**

*Respondents' current sourcing locations in Europe*



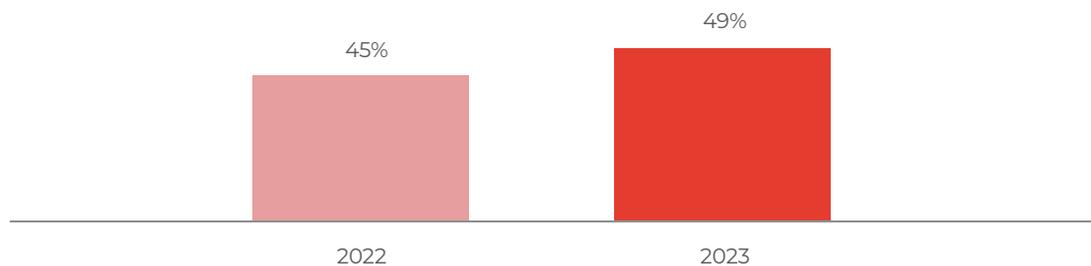
When asked about companies' current sourcing locations in Europe, the top three countries with the most respondents remained the same as last year while the ranking changed. Germany is still the first place with 43% of respondents. Germany has long been globally recognized as a manufacturing and export hub. With the "Industry 4.0 Strategy", Germany is expanding its world-leading technological advantages in advanced manufacturing, chemical industry, and machinery manufacturing. Poland and Italy are tied for the second place. Similar to Germany, Italy has long been a manufacturing giant in Europe, with strong technological superiority in heavy-duty machine tool production. Poland is vigorously developing the new energy automotive industry while its new electric vehicle lithium battery manufacturing capacity rose significantly, surpassing the United States and becoming the second largest in the world after China in 2022.

### 3.3 Current sourcing situation in Southeast Asia

Due to supply chain instability brought by factors such as geo-political tension and strict COVID-19 policies in China, it has become a trend for companies to adopt the “China Plus One” approach. With this approach, companies have relocated parts of their sourcing throughout Asia, especially in Southeast Asia, to reduce risks in their supply chains. As early as the 2010s, countries such as Vietnam, Malaysia, and Thailand quickly became feasible and attractive options for companies under the new strategy. The following section will look further into the region and compare it with data from previous years to give further insights into trends and shifts.

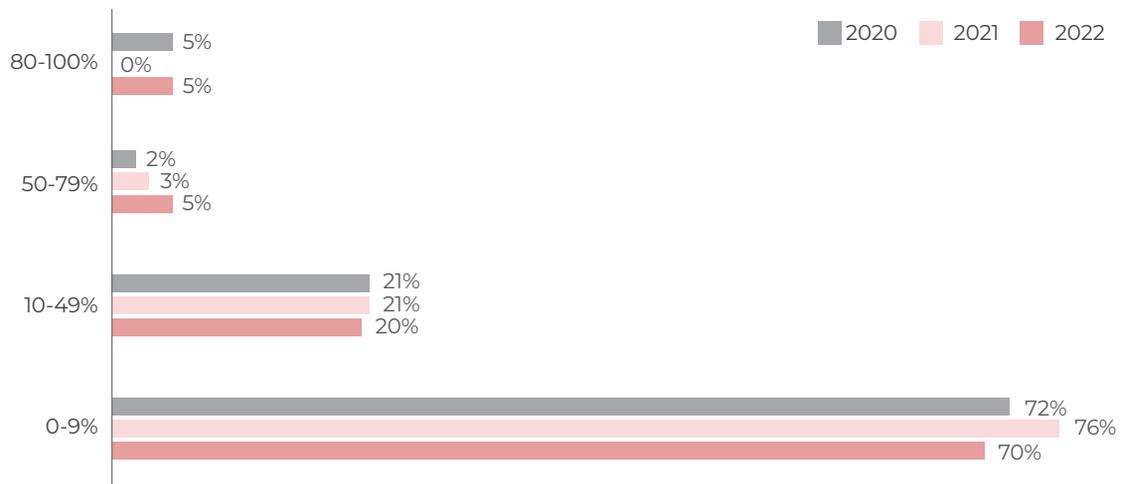
**Figure 11**  
**Current sourcing in Southeast Asia compared to 2022**

Share of respondents sourcing in Southeast Asia



**Figure 12**  
**Share of purchasing amount in Southeast Asia of global purchasing spend 2022**

Estimation of how large the purchase amount was in Southeast Asia compared to the global purchasing spent in the previous two years



**Figure 13**

**Reason for sourcing in Southeast Asia – to serve local demand or for global supply**

Share of the respondents choosing the alternative as their main reason for sourcing in Southeast Asia



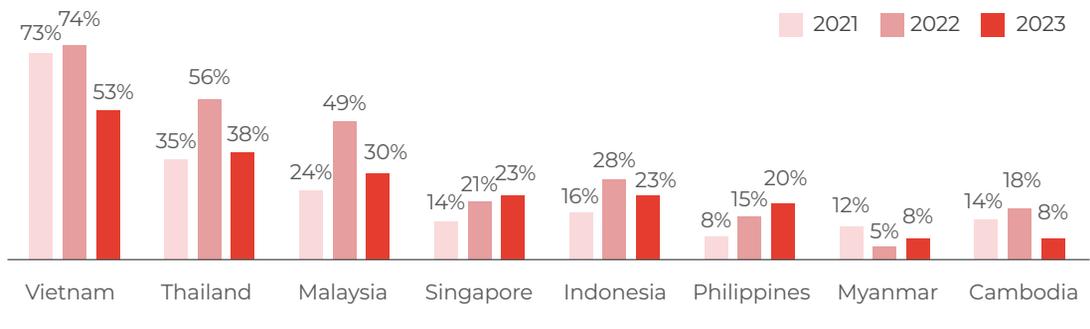
More and more companies have begun sourcing in Southeast Asia. When compared with 2022's data, the share of respondents sourcing from Southeast Asia increased from 45% to 49% as Figure 11 displays. According to Figure 12, the survey findings remain similar this year. The vast majority, 90% of the respondents spent less than 50% of their global purchasing amount in Southeast Asia. More specifically, 70%, of respondents sourced only 0%-9% of their total sourcing from this region. It is suggested by Figure 13 that European companies' sourcing in Southeast Asia mainly serves their global production demand though there has been a notable shift toward serving the local region.

Southeast Asia is experiencing strong market vitality and attracting more and more foreign capital. For example, according to the General Statistics Office of Vietnam, in the first half of 2023, a total of 1,293 new investment projects were signed in the country, achieving 79.1% year-on-year growth. However, the manufacturing capabilities of SEA still lag when compared with that of China and Europe. Nevertheless, there is no doubt that Southeast Asia, depending on its abundant labor and price advantage, serves a similar role as China in global supply chains.

**Figure 14**

**Sourcing locations in Southeast Asia**

Respondents' current sourcing locations in Southeast Asia



Vietnam was named as the top sourcing destination in Southeast Asia, with 53% of the respondents sourcing in the country, followed by Thailand and Malaysia, with 38% and 30% respectively. The top three countries with the most respondents remain unchanged this year. However, the top three countries lose some support to other Southeast Asian countries like Singapore, Indonesia, and the Philippines.

## 4 Relocating Trends

In these uncertain times, there is a growing trend of "relocating" in global supply chains. This means that companies are trying to find sources for their products closer to home and diversify their sourcing destinations, moving away from relying too heavily on certain manufacturing hubs like China. Throughout the three-year pandemic, many companies have suffered from shortages and delays due to disruptions in their supply chains and have come to realize how fragile their global supply chains can be. Although China's reopening at the end of 2022 is helping to bring the manufacturing sector back to normal, many analysts believe that policymakers and business leaders in the West are prioritizing reshoring/nearshoring to reduce risks in their supply chains and combat rising costs.

This chapter seeks to answer the following questions:

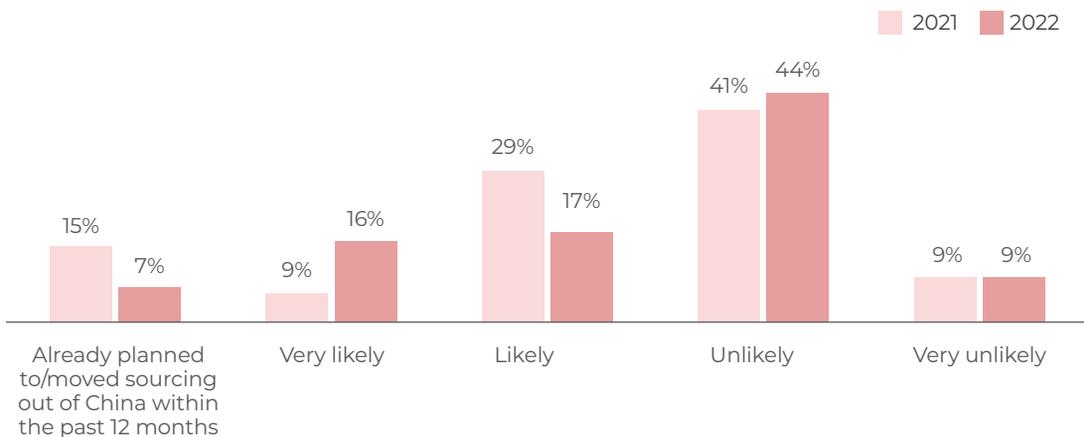
- Are companies moving their sourcing activity closer to homes, and if so, where?
- What are the underlying reasons why companies are moving or staying in their sourcing location?
- What are the most important factors when assessing a new sourcing location?

### 4.1 Likelihood to relocate sourcing activities

Figure 15

**Likelihood to completely or partially relocate sourcing out of China in the near future**

Share of respondents' likelihood to relocate their sourcing out of China



According to Figure 15, in 2023, 56% of the respondents stated that they would be less likely to move out of China, increasing by 6% from last year, highlighting their recovering confidence toward the Chinese market. Meanwhile, only 8% stated that they already had definitive or realized plans to move within the past 12 months, down 50%, probably due to the reopening policies in China during the end of 2022.

Figure 16

**Likeliness to completely or partially relocate sourcing out of Europe in the near future**

Share of respondents choosing the alternative in likeliness to relocate their sourcing

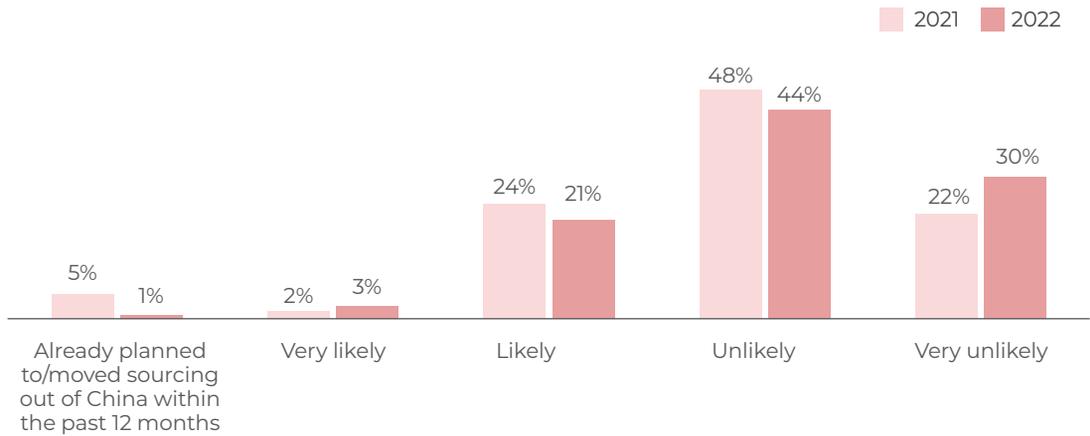
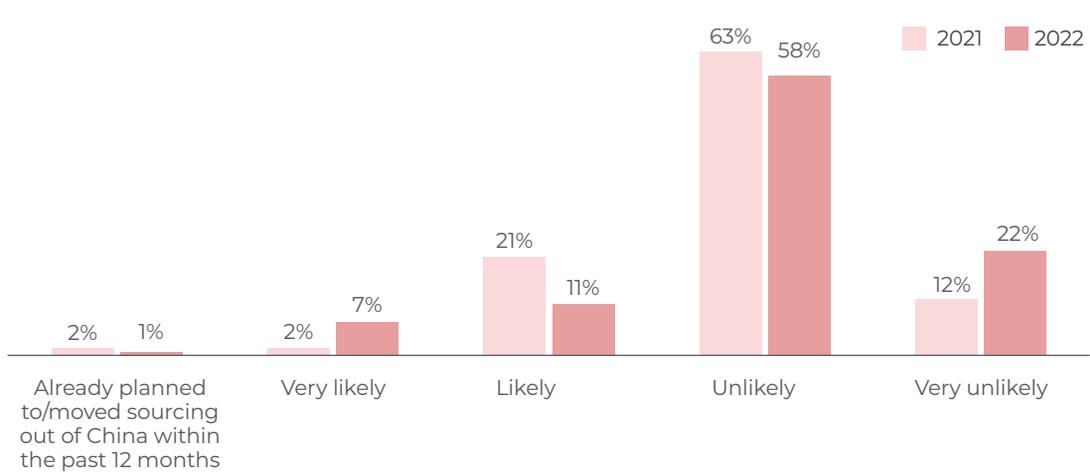


Figure 17

**Likeliness to completely or partially relocate sourcing out of Southeast Asia in the near future**

Share of respondents choosing the alternative in likeliness to relocate their sourcing



However, despite China's improved performance compared with 2021, Europe and Southeast Asia still maintain their gains from the COVID pandemic. Europe and Southeast Asia have a much larger share of respondents that are likely to stay in their current sourcing location when compared with China. 75% and 80% of respondents stated that they were unlikely or very unlikely to relocate their sourcing respectively. Few of the surveyed companies were very likely or had definitive plans to move, with only a total of 4% and 7% of respondents choosing the alternatives for the two markets. Europe had the most respondents being very unlikely to move out of the region.

The respondents perceive Southeast Asia and Europe as more secure sourcing destinations than China, as companies are more likely to relocate parts, or the entirety, of sourcing out of China.

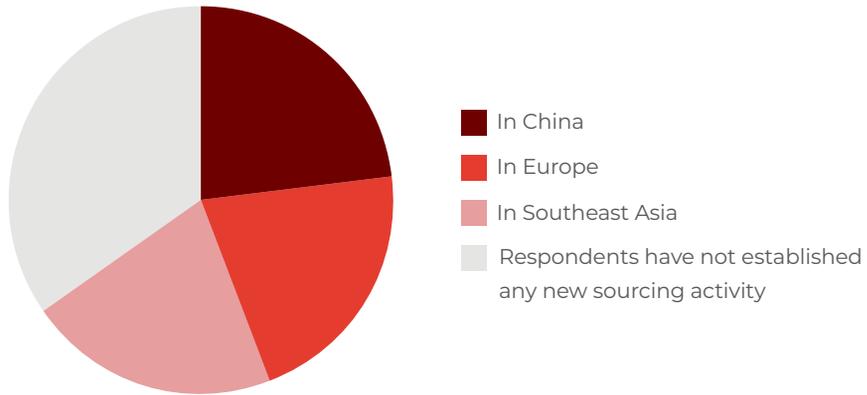
## 4.2 Relocating destinations

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**Figure 18**

### **The establishment of new sourcing activities in the past 12 months**

Share of respondents who have established new sourcing activities in the regions



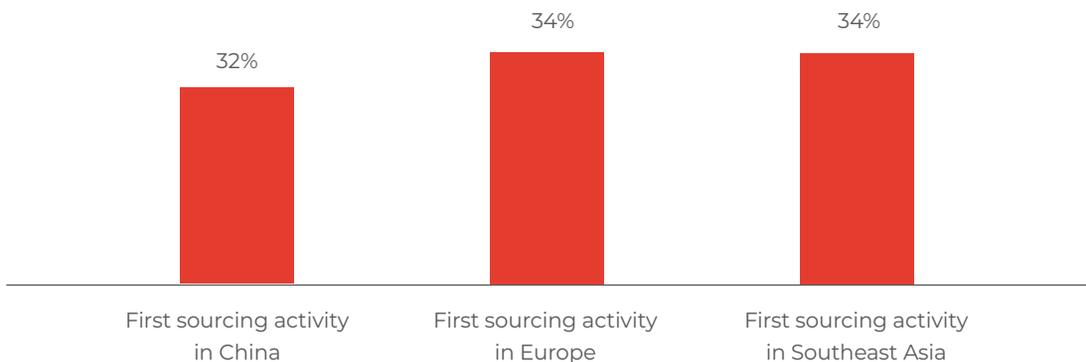
Despite the slightly higher share of companies being likely to relocate out of China compared to out of Southeast Asia and Europe, the share of companies who have established new sourcing activity in each of the regions is equally divided. As shown in Figure 18, China has become less popular, with respondents decreasing from 32% last year to 24%, for new sourcing activities. Among those who established new sourcing activity in each region, the proportions of respondents that stated that it was their first sourcing activity in all three regions were similar, around 30%.

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**Figure 19**

### **The establishment of sourcing activity in the region for the first time**

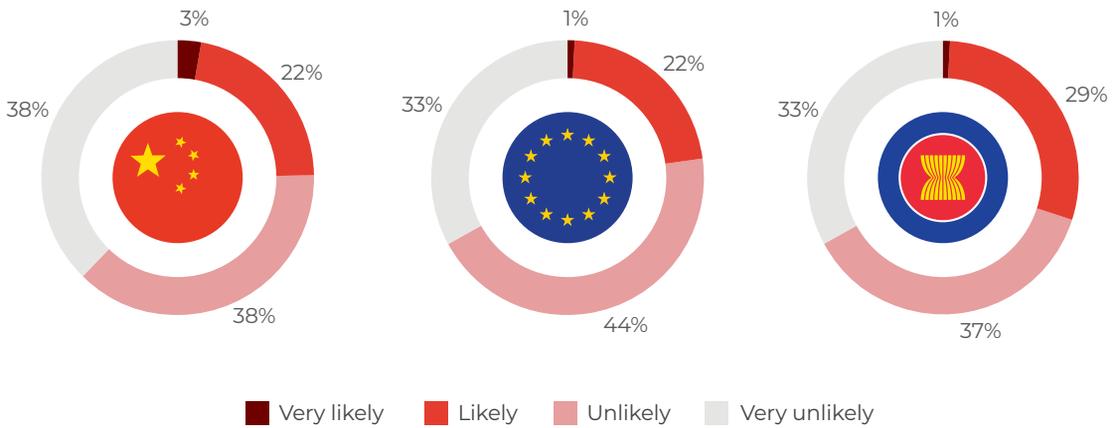
Share of respondents who established sourcing activity in the region for the first time



**Figure 20**

**Likelihood to move parts of sourcing to China, Europe & Southeast Asia**

Share of respondents without a previous presence in China, Europe & Southeast Asia who chose the alternative as likelihood to establish new sourcing activity in the region



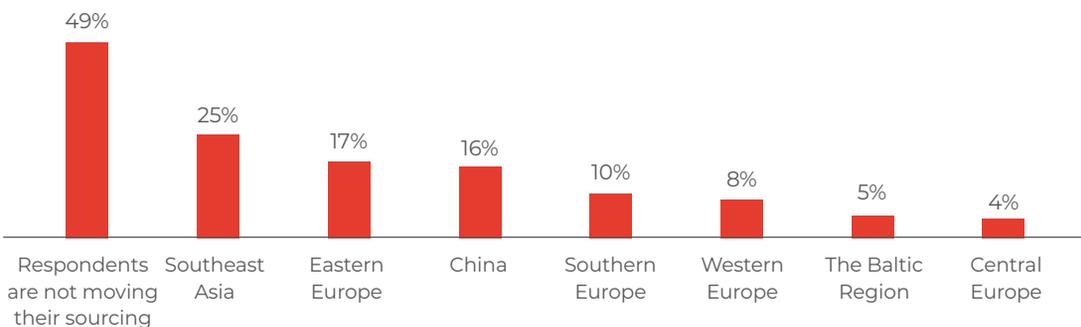
As displayed in Figure 20, when asked about the likelihood of moving parts of their sourcing activities to the three surveyed regions, only 25% found it likely or very likely that they would move at least a part of their sourcing to China. A similar level could be found for Europe, namely 23%. Among the three regions, slightly more respondents, with a 30% share, tend to move parts of their sourcing to Southeast Asia.

Nevertheless, the three regions stand in relatively similar positions when answering where companies are moving their sourcing to. While Southeast Asia now serves as an attractive alternative to China, additional efforts to strengthen its competitiveness as a global sourcing destination are still indispensable. By comparison, Europe holds strength in location and experience but lacks the essential cost advantages that China and Southeast Asia possess.

**Figure 21**

**Potential sourcing locations to relocate sourcing activity to**

Respondents' potential location to move their sourcing activity to

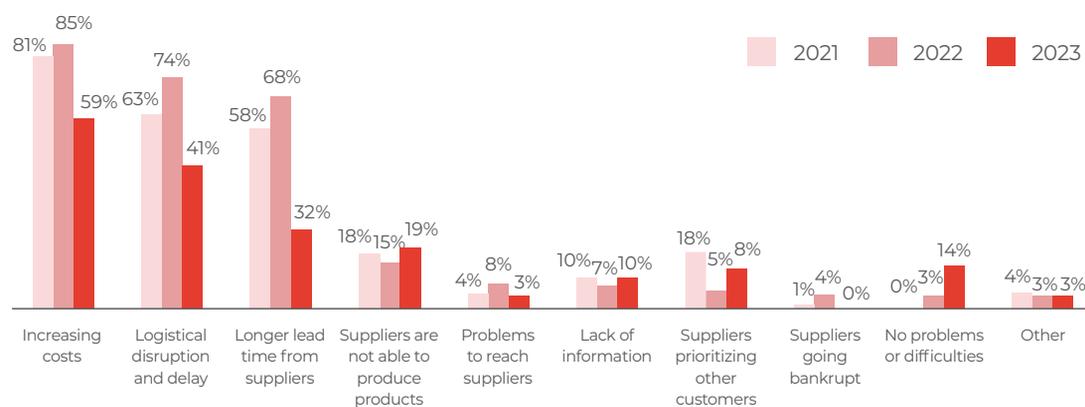


When asking specifically where companies would be more likely to relocate to, as shown in Figure 21, Southeast Asia is much more favorable than Eastern Europe and China. This year, however, nearly half of the respondents do not have plans to shift their sourcing destination. This may be influenced by current uncertainties, such as geopolitical risks and the high inflation levels globally. At the time of completing this survey, many companies were taking a more conservative investment strategy and a wait-and-see attitude.

### 4.3 Reasons to relocate

**Figure 22**  
**Top sourcing problems**

Share of respondents listing the top three sourcing problems they have encountered from 2021 to 2023



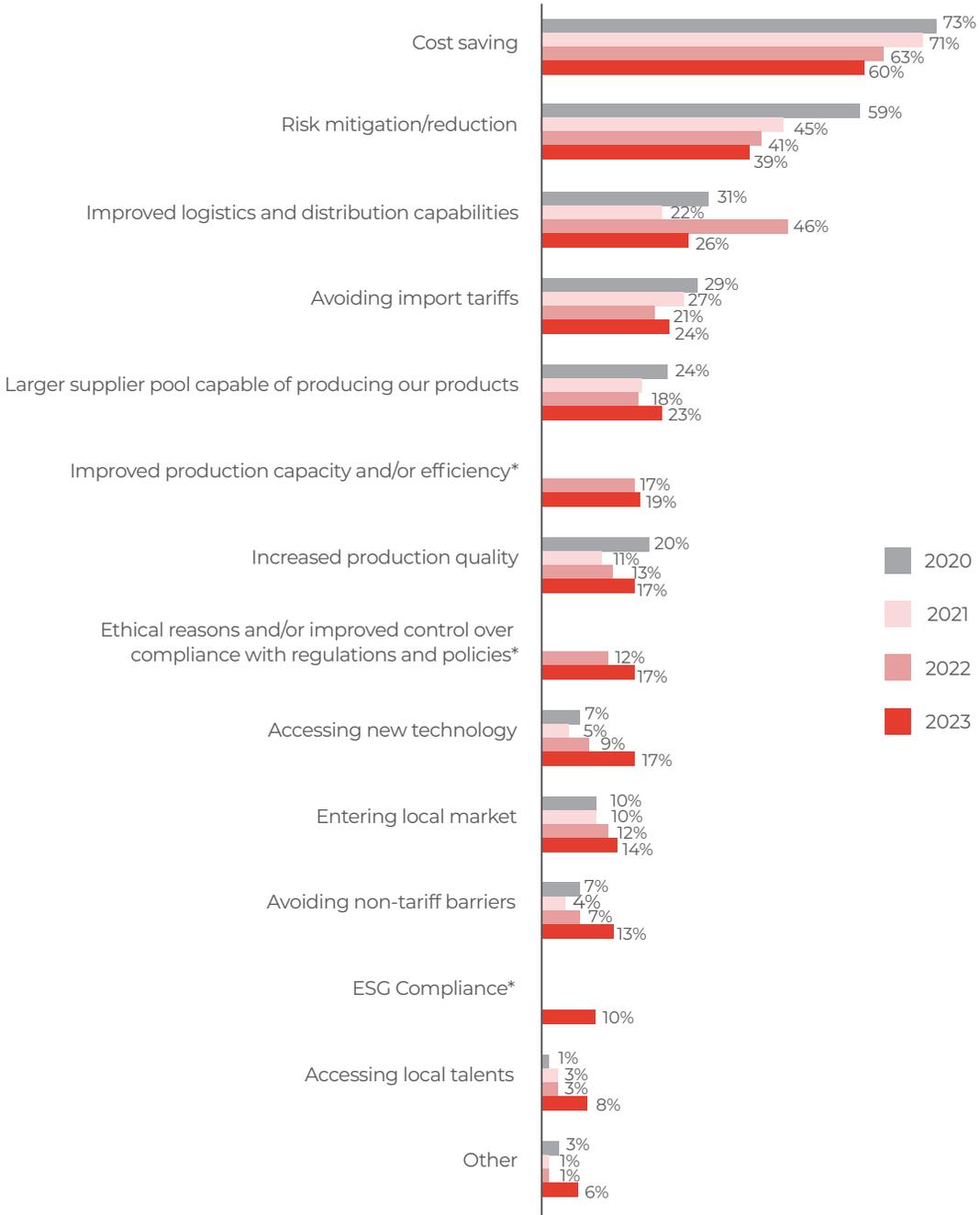
The three biggest challenges that companies have faced in 2023 remain the same as those of previous years. However, the challenges are on decreasing in severity as demonstrated by the falling percentage number. Figure 22 shows that 59% of respondents find their key sourcing problems included rising costs, followed by delays and logistical disruptions, as well as longer lead times, with 41% and 32% of responses respectively. On average, the top three problems declined by about 40% between 2022 and 2023.

The number of respondents answering “No problems or difficulties” also rises from 0% in 2021 and 3% in 2022 to 14% in 2023. This remarkable growth, coupled with the declining severity of the most pressing challenges, demonstrates the accelerating recovery of the global supply chains after much tumult between 2020 and 2022.

**Figure 23**

**Reasons for switching to a new sourcing market**

Share of respondents listing top three reasons for switching to a new sourcing market from 2020 to 2023



*“ESG Compliance” “Improved production capacity and/or efficiency” & “Ethical reasons and/or improved control over compliance with regulations and policies” weren’t included in previous surveys.*

Figure 23 displays that the different stimulators for relocating sourcing largely correspond to the problems companies have faced in their sourcing activities.

## **Cost Savings**

Cost saving maintains the top reason why companies chose to relocate. As COVID-19 swept through China, manufacturers faced a variety of financial headwinds in 2022, including elevated logistics costs and production disruptions. Shortages in labor and supply, soaring demand following the end of the pandemic, and geopolitical risks are causing surging inflation in raw materials. Under the rising costs trend, companies can save on transport-related spending by moving sourcing destinations closer to the original country.

Considering the inevitable trend of rising costs in China, Southeast Asia serves as an attractive alternative with cheaper labor and operational costs, as well as favorable free trade agreements. The decline in the share of respondents mentioned this factor may partly attribute to the reopening of China. China remains competitive due to the country's well-established manufacturing hub which can offer consistent product quality and production efficiency. Companies tend to tolerate higher costs for better quality control, compliance, and risk management.

## **Risk Mitigation**

A second key factor for companies to relocate is risk mitigation, with 39% of respondents prioritizing this when finding new sourcing markets. Global supply chains experienced severe turbulence during the pandemic, and previous sourcing surveys revealed that many companies were not prepared, and many international companies were forced into bankruptcy due to the unavailability of products and labor force. Companies heavily invested in China, relying fully, or partly on the country for its sourcing or manufacturing were affected the most. Companies today, looking back at the challenges posed in recent years, have realized the importance of diversifying their supplier base into more markets to help mitigate potential risks.

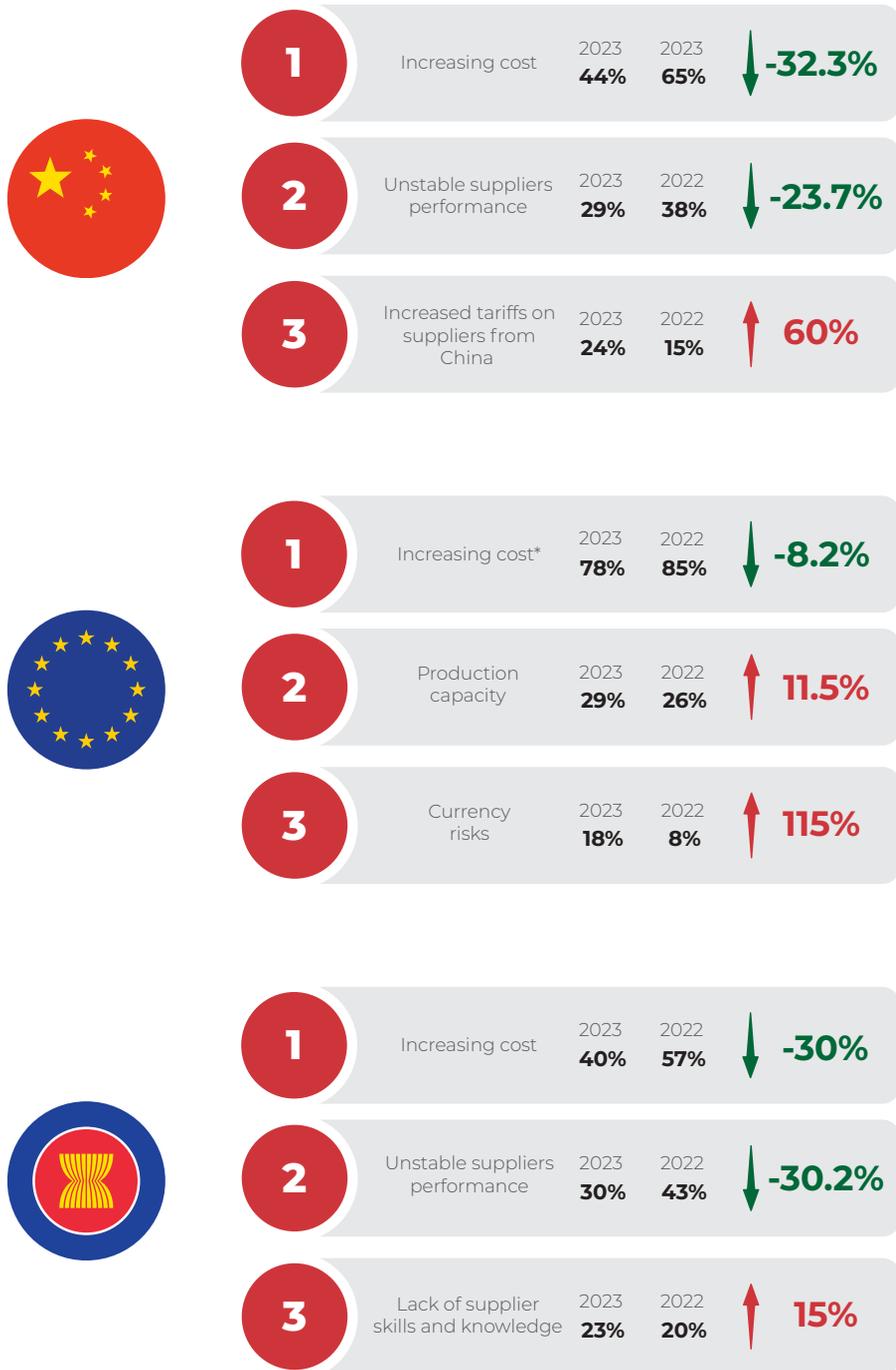
## **Improved Logistics And Distribution Capability**

Improved logistics and distribution capabilities are the third most important reason for finding a new sourcing market, with 26% of respondents stating it as one of their main drivers to move. In recent years, many companies suffered from the logistics breakdown. As such, reshoring or nearshoring is developing as a strategy to help companies strengthen their control of logistics and avoid unstable deliveries by shortening the shipment distance.

Figure 24

**China, Europe & Southeast Asia sourcing risk factors of most concern compared to 2022**

Share of respondents listing the category as one of their perceived top three risk factors



The above data provides a more detailed view of the risks companies denote to each of the examined markets. In summary, each of the regions holds its strengths and weaknesses, which are all creating obstacles when considering the markets for establishing new sourcing activity. The surveyed companies were asked to rank the top three risk factors that they associated with each region. Rising cost is the top reason for all three markets, however, other concerns vary depending on the market.

## **Increasing Costs**

Increasing costs was the most significant risk factor for sourcing in all three regions. China and Southeast Asia had a similar share of respondents who ranked it as one of the top three risk factors, whereas a much larger share stated this for Europe with more than 30% points higher.

In China and Southeast Asia, although increasing costs remained the top risk factor, the share of respondents for both dropped by more than 30% compared to 2022. Europe held the highest percentage share among the three regions at 78%, a slight decrease from 85% in 2022. While high labor and operational costs are more expensive in the region, high inflation, and rising commodity prices, which particularly affected the European region, have been significant contributors this year.

## **Unstable Supplier Performance**

Unstable supplier performance is regarded as the second most concerning factor for sourcing in China and Southeast Asia. This could be due to the wide lockdowns in manufacturing cities such as Shanghai, Foshan, and Suzhou in China during the second quarter of 2022 which caused additional production delays, adding to the disruptions of the past two years. Even though China implemented many strategies to avoid the closure of factories and harbors, the strict COVID measures still halted production and caused uncertainties in the country's supply chain. Many countries in Southeast Asia were also struck by lockdowns and surges in COVID cases during the 2022 H1. However, as a consequence of the production recovery in these two regions, the concern about supplier performance was weakened when compared with last year.

## **Production Capacity**

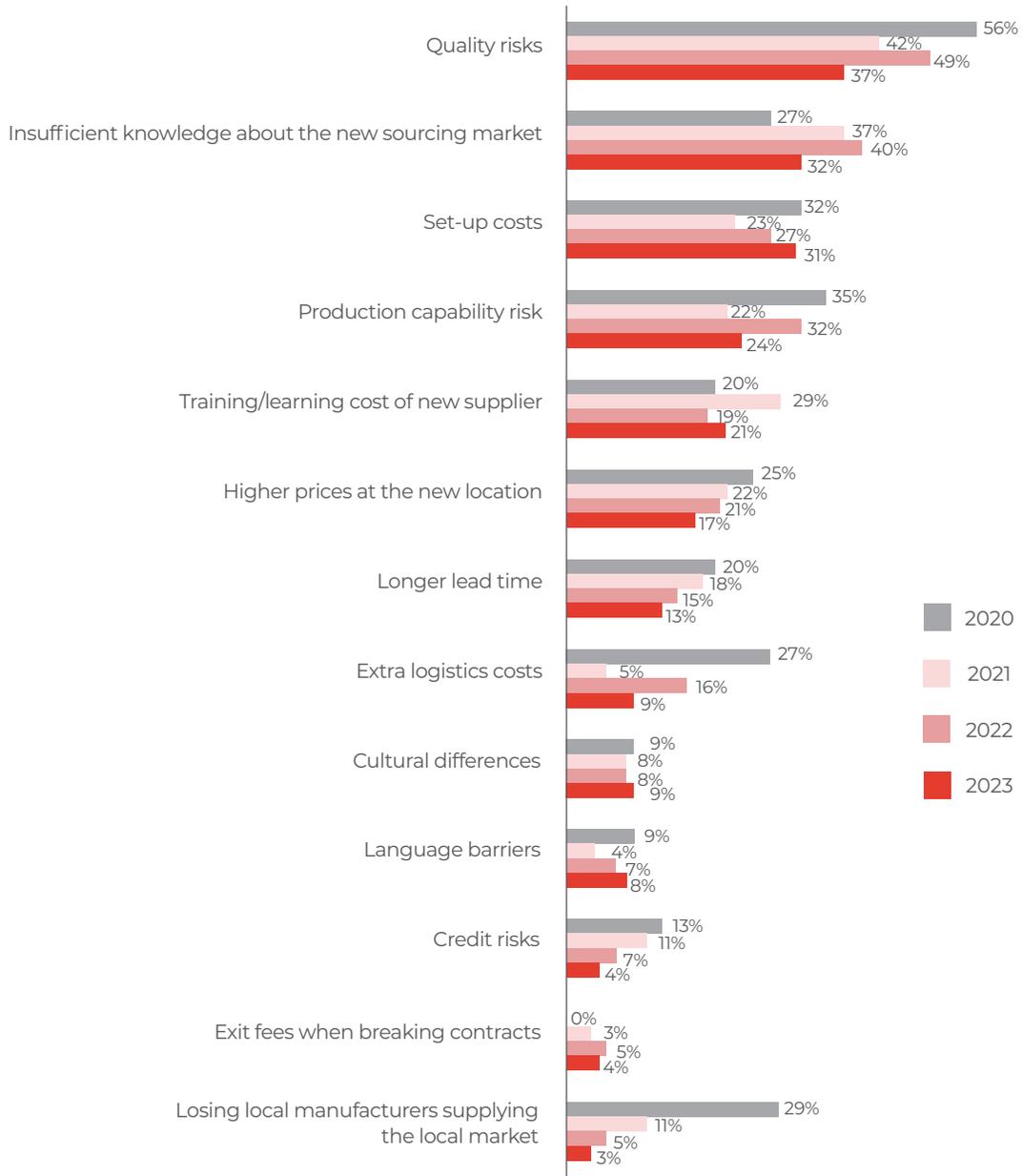
Production capacity rose from the fourth to the second biggest concern for companies sourcing in Europe with 29% of respondents concerning it. The increased mention may be due to Europe's energy crisis last year which significantly hindered the manufacturing sector in Europe. Many factories shut down and reduced production, increasing the European supply chain's dependence on other markets.

## 4.4 Reasons for staying

Figure 25

### Main barriers to consider when entering a new sourcing market

Share of respondents listing the alternative as one of their perceived top three barriers



Nevertheless, the rate at which companies are relocating is relatively low and many companies are even starting new sourcing activities in the same locations they have been in despite the risks. This development demonstrates that finding the right alternative sourcing market remains complicated and not without its risks and challenges.

## **Quality Risks**

Decreasing from 49% last year, this year 37% of the respondents consider quality risks as the most significant barrier when entering a new market. Extensive experience and relationships with existing suppliers in a market facilitate companies' ability to predict the output and quality of their sourcing, and moving to an unknown market brings uncertainties and qualitative risks. Performing extensive quality controls of new suppliers is a costly but necessary measure to take to ensure that the requirements are met.

## **Insufficient Knowledge About the New Sourcing Market**

Insufficient market knowledge ranks as the second most common concern, decreasing from 40% to 32% this year when companies enter a new sourcing market. Lack of experience in market behaviors and knowledge, such as the market's capabilities, available resources, policies, strengths, and weaknesses, are some specific challenges that companies face when entering new markets. Many companies may lack the resources to perform the research that is necessary to understand the market, as it can be both time-consuming and complicated without a local presence. Companies may benefit from hiring a local resource or appointing consultants with market insights to support the entry.

## **Set-up Costs**

Set-up costs rank third, chosen by 31% of the respondents. Launching a business in a new market requires a significant investment of money. The cost may involve market research expenses, marketing expenses, supplier searching and training expenses, and many more. Each of these costs needs to be carefully considered and budgeted as many of these costs are sunk costs that cannot be recovered when a firm leaves a market.

# 5 The Role of ESG in Sourcing

Tackling climate change and environmental issues is becoming an increasingly important factor for companies, fueled by pressure from both politics and customers. For example, the EU is implementing the world's first carbon tax and will start to demand carbon footprint data from 2023 and introduce a carbon border tax from January 2026. This will increase the cost of importing products with significant emissions. In November 2022, the European Parliament passed the Corporate Sustainability Reporting Directive (CSRD), which is expanding from Non-Financial Reporting Directive (NFRD). Directly, enterprises that fail to comply with relevant information disclosure regulations and compliance requirements proposed by CSRD may face business risks such as supervisory punishment, decline in sales orders, and damage to corporate reputation. Indirectly, since CSRD requires information disclosure about the value chain, suppliers that cannot meet the requirements of sustainable development management will be largely affected by the corresponding business stagnation.

Consumers' sentiments are shifting toward more environmentally and socially responsible business practices, which affect companies sourcing activities. This, together with governments in Europe and the US tightening regulations, indicates that supply chain sustainability is a growing concern for businesses. As a result, environmental, social, and corporate governance (ESG) practices have emerged as one of the most important benchmarks to gauge the sustainability of corporate sourcing activities. This section will delve into three areas relevant to ESG: carbon footprint, fair labor, and corporate integrity.

This chapter seeks to answer the following questions:

- To what extent do companies have access to and assess their suppliers' sustainability data in the three surveyed regions?
- What are the respondents' main methods of assessing sustainability performance?
- What motivates companies in assessing such information?

## 5.1 The state of ESG reporting in China, Southeast Asia, and Europe

**Figure 26**  
**Suppliers' carbon footprint data sharing percentage**  
*Share of respondents receiving carbon footprint data from their suppliers*

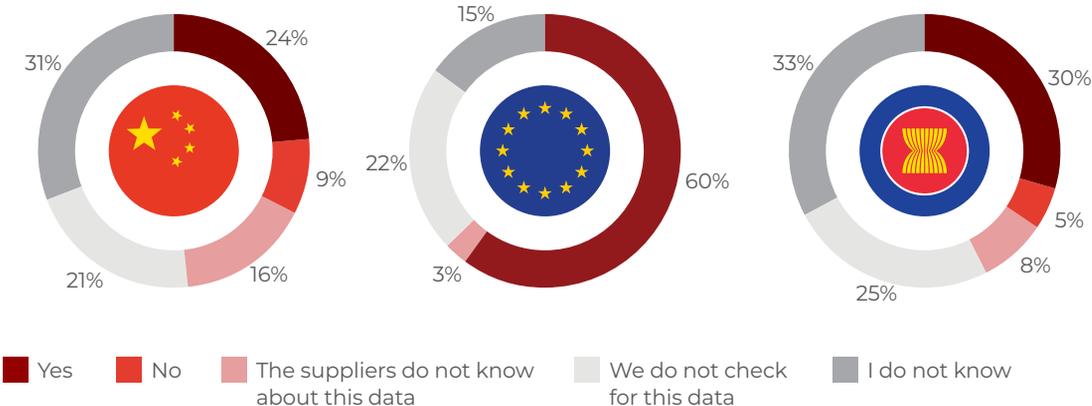
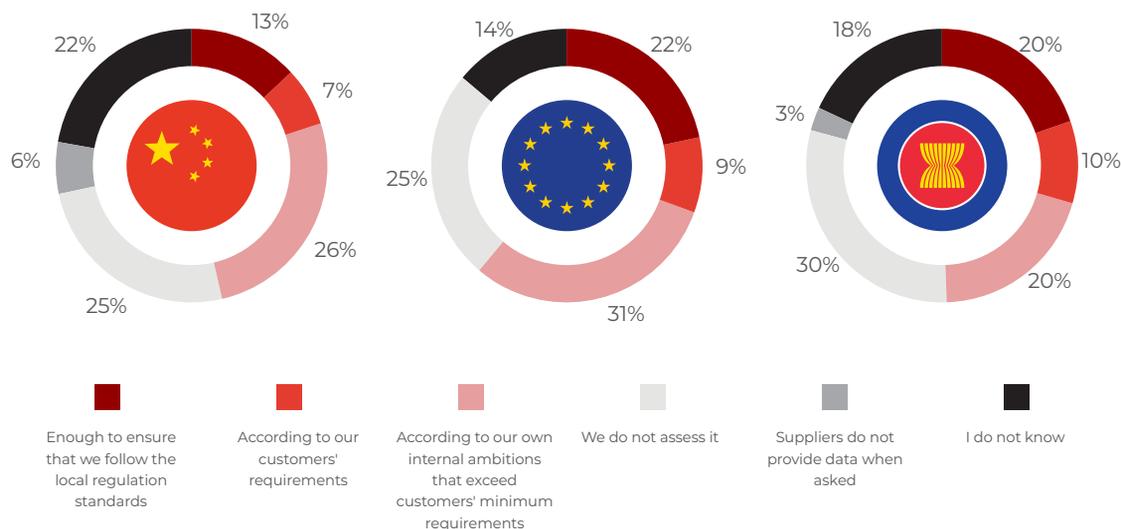


Figure 27

### Suppliers' carbon footprint data assessing the percentage

Share of respondents assessing carbon footprint data of their suppliers



Over half of the companies that source products from China (51%) and Southeast Asia (58%) do not check or have any knowledge of their suppliers' carbon footprint data. In Southeast Asia, only 30% of companies receive carbon footprint data from their suppliers, while in China, the figure is even lower at 24%. In comparison, only 37% of companies sourcing from Europe claim to have no knowledge or ignore carbon footprint data, and a vast 60% of these companies receive such data from their suppliers. It is also noteworthy that none of the European companies reported that their suppliers did not provide carbon footprint data.

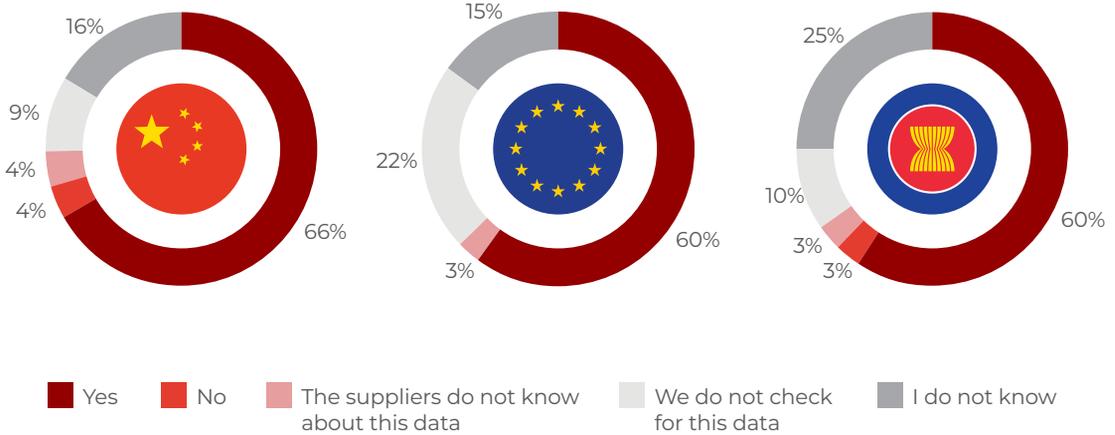
Companies that source from China and Southeast Asia have lower rates of assessing their suppliers' carbon footprint data. In China, only 46% of companies assess their suppliers, while in Southeast Asia, it's 50%. Conversely, 62% of companies that source from Europe assess their suppliers. However, all three regions have a high number of respondents who don't assess this data due to a lack of action, an inability to gather data from suppliers, and a lack of knowledge about the metric. In China, the figure is 53%, in Southeast Asia, it's 51%, and in Europe, it's 39%.

The survey results for China and Southeast Asia demonstrate that carbon footprint has not yet become a significant issue for companies given the high rate of unawareness. On the other hand, with stricter regulations such as the European Climate Law, European companies are forced to pay more attention to data on the carbon emissions of their suppliers. Nevertheless, all three regions still have much to improve in terms of assessing carbon footprint data.

**Figure 28**

**Suppliers' fair labor data sharing percentage**

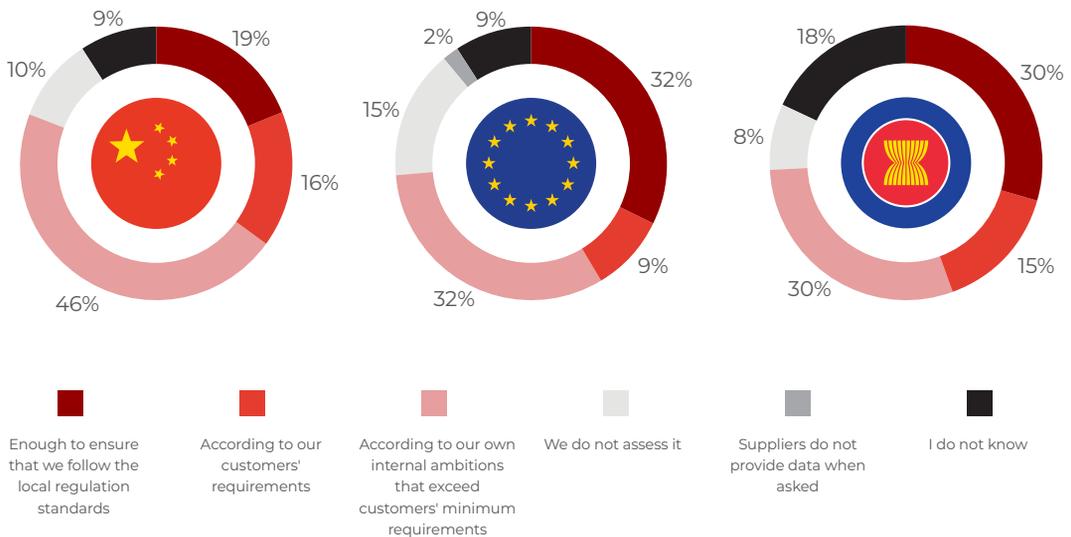
Share of respondents receiving fair labor data from their suppliers



**Figure 29**

**Suppliers' carbon footprint data assessing the percentage**

Share of respondents assessing fair labor data of their suppliers



"Fair labor includes fair pay, reasonable working hours, prohibition of child labor, and adequate workplace safety.

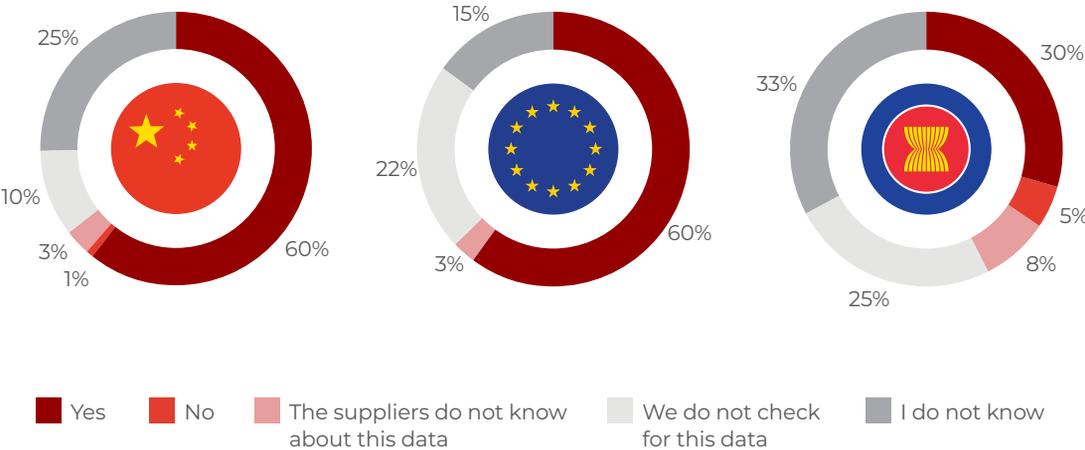
In stark contrast to the data on carbon footprint, 66% of companies sourcing in China and 60% of companies sourcing in Southeast Asia said that their suppliers were willing to share data on fair labor conditions. These figures are on par with Europe's 60%. At the same time, however, 16% of companies sourcing in China, 17% in Europe, and 25% in Southeast Asia stated that they did not know about this data. This points to a relatively low, but still substantial, lack of knowledge regarding fair labor data.

In addition, companies are also equally eager to assess the fair labor data of suppliers. 81% of companies sourcing in China, 75% of companies sourcing in Southeast Asia, and 73% of companies in Europe said that they assess their suppliers to some extent. Despite these rosy figures, Europe and Southeast Asia still need some improvement compared with China. For Europe, 15% of respondents said that they did not assess fair labor data, the highest among the three regions. For Southeast Asia, the problem lies in the substantial (18%) number of respondents who remain unaware of such data.

The high percentage of both data sharing and assessing in fair labor data points to the fact that this issue is much more visible and relevant to everyday life for companies, suppliers, and workers. As a result, this issue receives much more attention than carbon footprint, which only attains a high degree of awareness in Europe.

**Figure 30**  
**Suppliers' corporate integrity data sharing percentage**

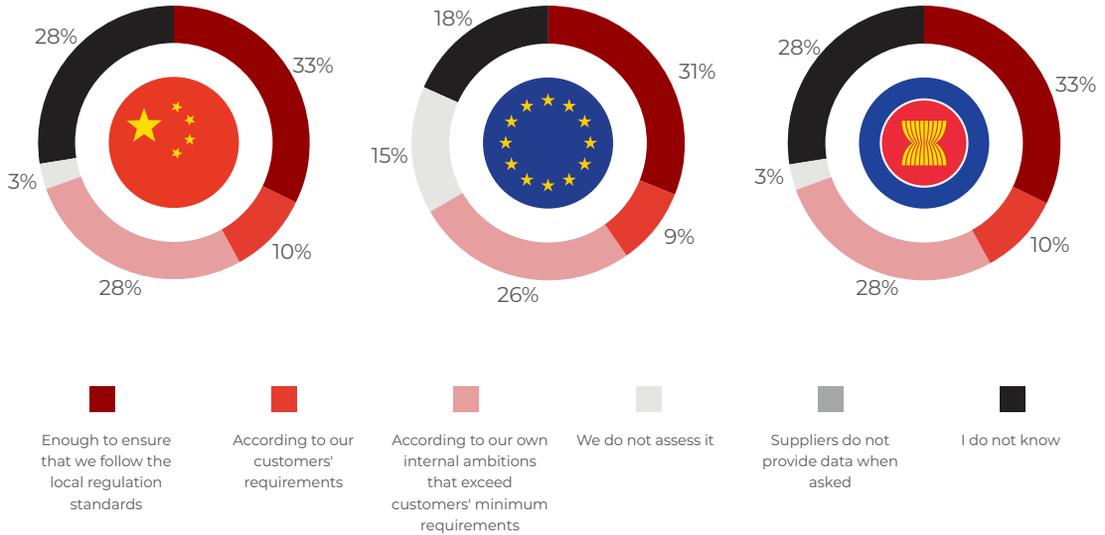
*Share of respondents receiving corporate integrity data from their suppliers*



**Figure 31**

**Corporate integrity data assessing corporate integrity data**

Share of respondents assessing corporate integrity data of their suppliers



*\*Corporate integrity refers to the ethical and moral principles that guide a company's behavior and decision-making processes. It encompasses honesty, transparency, and accountability in all aspects of business operations, including interactions with stakeholders such as employees, customers, suppliers, and the wider community.*

Similar to fair labor data, a high percentage of companies surveyed received information regarding corporate integrity. Companies sourcing in China and Southeast Asia recorded that 60% of suppliers provided this information. Companies sourcing in Europe recorded a 71% rate. At the same time, 25% of companies sourcing in Asia stated that they did not know about this data. This rate is only 15% in Europe, indicating that knowledge about corporate integrity data has more penetration in Europe than in the other two regions.

Companies sourcing in all three regions have a similar rate of approximately 70% in terms of assessing corporate integrity data. More impressive is the fact that across the three regions, nearly 25% of companies said that they went above and beyond the requirements of the customers. At the same time, a similar proportion of companies sourcing in China and Southeast Asia do not know about this operation while the rate is nearly as high in Europe at 18%. These figures point to a small but still prominent lack of awareness of corporate integrity matters across all three regions.

Overall, the high rate of both sharing and assessing corporate integrity data could boil down to the fact that corporate data is readily available and almost always legally required for companies and suppliers.

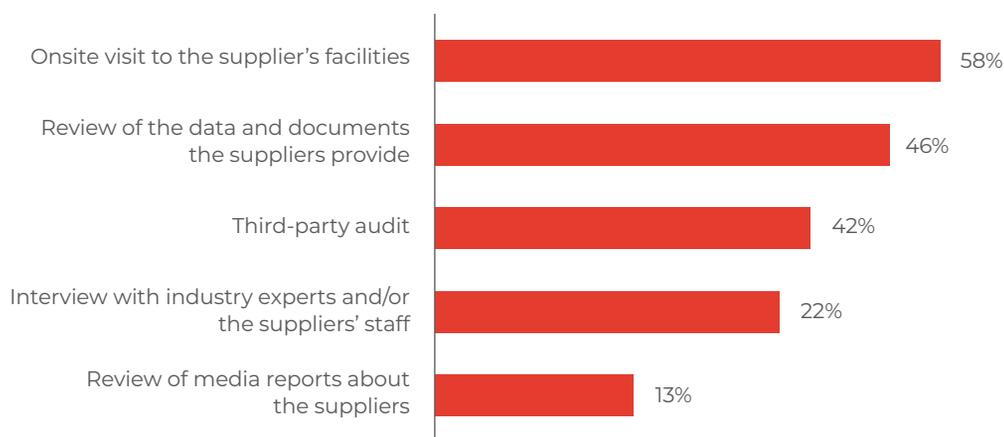
## 5.2 Strategies to ensure suppliers' ESG Compliance

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Figure 32

### Strategies for ensuring suppliers' ESG compliance

Share methods for ensuring ESG compliance of suppliers (Select all that apply)



To shed light on how companies ensure ESG compliance among their suppliers, the survey polls the methods which companies are utilizing to ensure that their suppliers are complying with ESG standards. The results show that on-site visits (58%), reviewing of the data from the suppliers (46%), and using third-party audits (42%) are the most popular means. Interview with industry experts or suppliers' staff is also mentioned though at only 22%. At the same time, reviewing media reports about the suppliers has the lowest share at only 13%

The low percentage of reviewing media could be due to the method's inability to present respondents with a more detailed look into the suppliers' operations and their performance. Furthermore, the method is relatively passive, relying on the reporting of news outlets that may not adequately address each company's requirements and can only cover the most prominent companies, not small or mid-size ones. By contrast, on-site visits can afford the companies the most detailed look into the suppliers' ESG performance.

It must be noted, that not one method is used exclusively but together with others to achieve the most comprehensive view of the suppliers' ESG performance. While on-site visits can provide the most intimate look into the suppliers' operations, reviewing suppliers' data, as well as other methods, will give companies the most comprehensive picture.

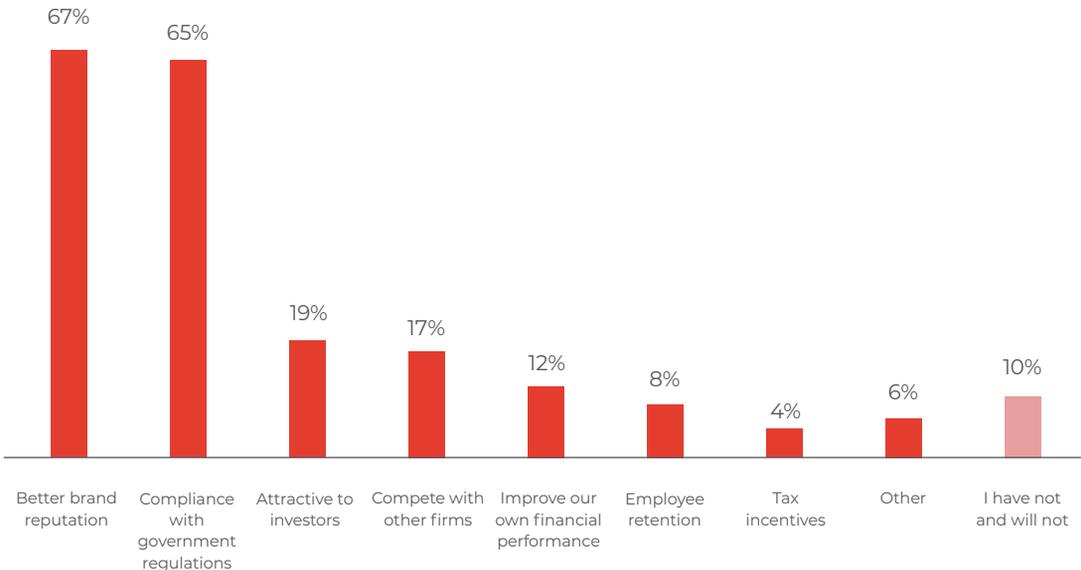
## 5.3 Motivations for using ESG to choose suppliers and sourcing destinations

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Figure 33

### Motivations for ensuring suppliers' ESG compliance

Share reasons for ensuring ESG compliance of suppliers now and in the future.



To gain a complete understanding of suppliers' ESG performance, companies should use a combination of methods, including on-site visits and data reviews. Figure 35 highlights the motivations for ensuring suppliers' ESG compliance, and businesses in all three regions are increasingly aware of the importance of ESG performance. While there is still room for improvement, the trend toward prioritizing ESG compliance among suppliers is undeniable.

Based on the data, it seems that companies are more influenced by the possibility of facing legal consequences from governments than by tax incentives. Furthermore, the research suggests that reputation is a major factor driving businesses to prioritize ESG in their supply chain. This reflects a global shift in consumer attitudes toward sustainability in the supply chain. According to a recent PwC survey, approximately 80% of respondents stated that ESG performance would impact their purchasing decisions in 2021. Given the growing importance of ESG to consumers, it's understandable that companies would prioritize their brand image accordingly.

# 6 Future of Sourcing

Businesses are recognizing the importance of diversifying their supplier base, even if alternative markets cannot offer the same advantages as China. This is necessary to mitigate risks and potential disruptions caused by over-reliance on a single location. The report has analyzed current trends in global supply chains, and this chapter explores what we can expect in the future. Companies were surveyed about their recent sourcing activities, their willingness to shift sources, the obstacles they face when establishing new sources, their future strategies, and the importance of different sourcing markets in their operations.

This chapter seeks to answer the following questions:

- What are the risk-mitigating strategies of companies for their sourcing activities?
- What is the perceived future importance of the sourcing markets of China, Europe, and Southeast Asia?
- To what extent do companies conduct new sourcing activities in China, Europe, and Southeast Asia in the past 12 months?

**Figure 34**  
**Risk mitigating strategies for companies sourcing 2023**  
 Share of companies' risk mitigation strategies they implement in 2023



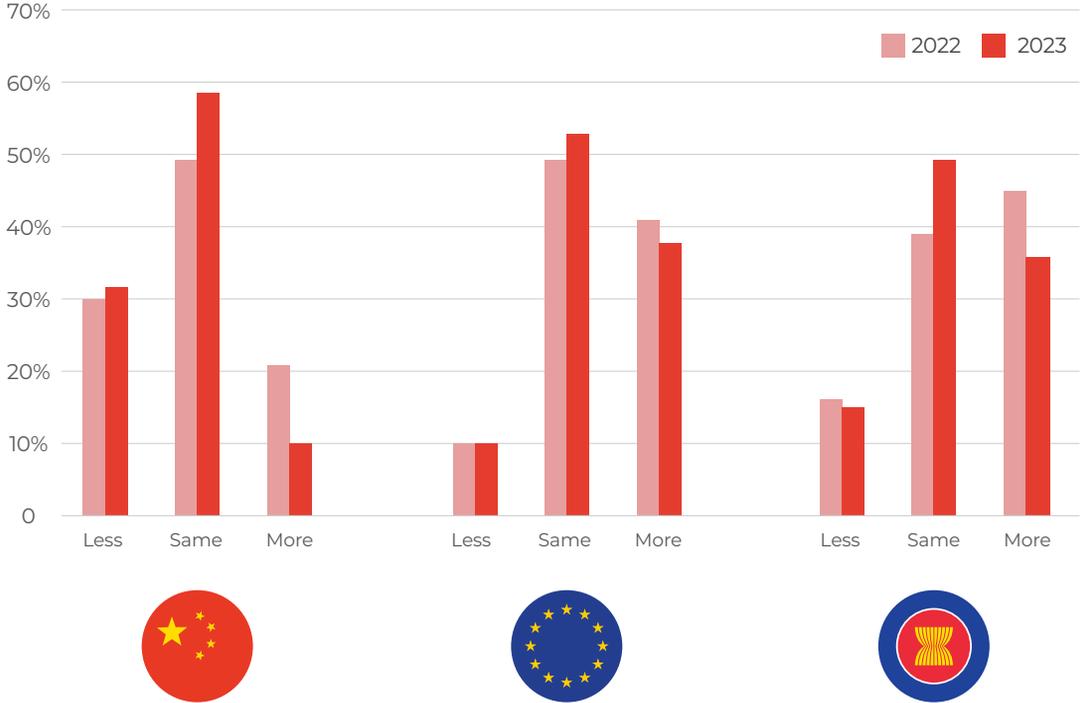
\*Reshoring/nearshoring sourcing activity closer to the market we operate in" was not included in the surveys before 2022.

In 2023, 44% of respondents plan on diversifying their supplier base to other countries as a risk mitigation strategy, a sharp decrease compared to the result from 2022 of 67%, but a slight increase to the result of 2021. This development could be because China eased COVID restrictions at the end of 2022, after 3 years of lockdown. These factors could explain why businesses do not have as much of a need to diversify their sourcing as in 2022. However, the still high figure points to a lingering uncertainty in global supply chains.

The second most common strategy is to enhance communication with suppliers., with 38% of respondents choosing this method. Clear and timely communication with current suppliers helps the business to mitigate potential risks from the early stage. Finally, 24% of companies are developing new risk management processes, which is lower than in 2021 and 2022. Such figures are because companies have implemented risk management processes during the COVID years and 20% of respondents haven't developed a new sourcing strategy for this year, which is an increase from 12% in 2022. The companies have been able to adapt to COVID-19 disruptions. This year can be considered a less tumultuous year compared to the previous two years. The sourcing strategy developed in the previous years might also be expected to perform well this year without major alterations.

**Figure 35**  
**Expectations of China's, Europe's, and Southeast Asia's importance as a sourcing market in the future compared with 2022**

Share of respondents' perception of regions' importance as a sourcing market in the future



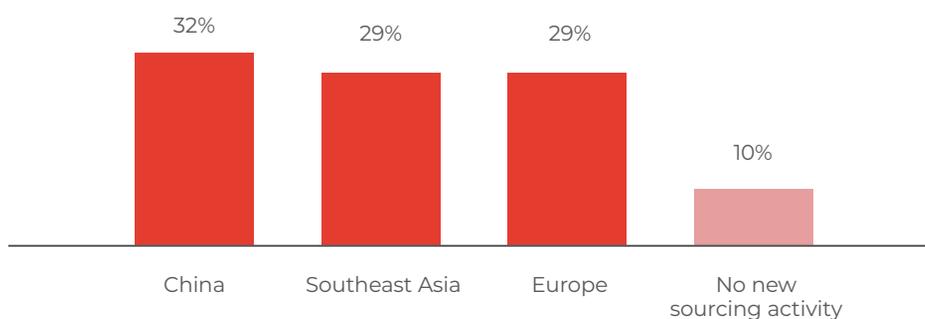
As shown in Figure 35, 68% of respondents perceive that China will be more important or remain of the same importance in the future during the 2023 survey. This is a slight decrease from the 2022 Survey, with 70% holding the same view. The decrease is highly influenced by a decline of 11% in the number of respondents stating that China will become more important in 2023 compared to 2022. This is because some were relocated during COVID-19; secondly, the strategy of de-coupling and de-risking of US and European countries continued to carry out to reduce these countries' reliance on the Chinese sourcing market in response to the increasing tension between these countries and China. 32% of respondents believe that China will be less important in the future, a slight increase from 30% in 2022's results.

On the other hand, Southeast Asia receives favorable responses compared to the previous year, with a note that a hike of 10% of respondents from the previous year are seeing the region with the same importance. The dependence on China for various components and the respondents' product complexity might be a contributing factor to why the region has a lower response in its importance.

The trend of conducting sourcing activities in Europe has accelerated faster than in Southeast Asia in the same period. Specifically, 37% of respondents see that their sourcing activities in Europe will be increasingly important in the future, in comparison to 41% in 2022. Global supply chain disruptions during the COVID-19 pandemic have prompted companies to become more aware of the benefits of conducting their sourcing activities close to their headquarters. This is to avoid problems similar to those happening during COVID-19. In addition to proximity, other factors such as the common EU market that reduces cross-border trade and travel frictions as well as an already established industrial base also contribute to companies settling in Europe for their sourcing market.

**Figure 36**  
**New sourcing activity in the last 12 months**

*Respondents shared the new sourcing activity in the last 12 months*

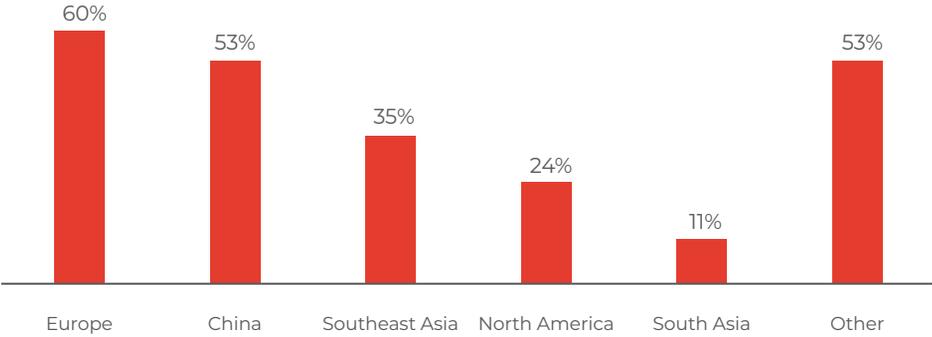


Based on Figure 36, 90% of the respondents who took the survey have started new sourcing activities across China, Southeast Asia, and Europe. China is the most popular sourcing destination, accounting for 32%, followed closely by Southeast Asia and Europe, each with 29%. Despite China remaining the primary destination, Southeast Asia and Europe are gaining traction as the next big sourcing markets. According to a study by Vietnam Investment Review, Southeast Asian countries still rely heavily on China for most components, but their manufacturing capabilities have significantly improved.

Additionally, the Regional Comprehensive Economic Partnership, one of the most extensive regional free trade agreements globally, is expected to provide incentives to supply chains in the region, reducing regional trade tension. This development will enable industries in Southeast Asian countries to benefit from the global value chain. Meanwhile, Europe remains a major sourcing market for European companies. Overall, the three regions are equally appealing to companies looking to establish new sourcing activities.

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**Figure 37**  
**The prominent sourcing countries in the future**  
*Share of important sourcing destinations in the future*



\* "Other" includes countries such as Turkey, Chile, and Argentina

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According to Figure 37, China and Europe hold the leading position as the most prominent sourcing destinations in the future, with more than 50% of respondents selecting both. Southeast Asia is also a prominent sourcing destination with 35% of respondents selecting countries in the region, such as Vietnam, Malaysia, and the Philippines. Within the region, Vietnam is the most popular destination at 21%. This is because with its proximity to China, the importance of Vietnam has grown tremendously in the last five years, and this will continue as Vietnam offers many advantages, such as its low labor costs and business environment, highly-proactive government to deepening trade ties with major economies such as EU and China, large and young workforce. The Philippines and Malaysia are also getting attention as the sourcing markets in the region as well.

Intriguingly, 53% of people chose "Other," indicating that sourcing activities are moving in a state of flux with traditional sourcing markets such as China having to contend with not only Southeast Asia, North America, and South Asia but also regions such as West Asia and Latin America.

## 7 Conclusion

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China's cessation of its Zero-COVID policy has helped the country regain some of its luster as a sourcing destination after three years of COVID-19 pandemic disruptions, including highly costly lockdowns. The country's comprehensive supply chain ecosystem, cost-efficient production, and experienced manufacturers continue to be China's greatest assets. Nevertheless, this does not mean that things have returned to the pre-COVID-19 states in full. Instead, companies have reduced their purchase spending in China. Although the current level of spending is still impressive, it has become lower than in previous years.

This development is emblematic of a trend in which companies have hedged against the risks of relying on one single sourcing location. By continuing to build new sourcing activities in Europe and Southeast Asia as part of their "China Plus One" strategy, companies are making sure that their risk exposure is kept at a manageable level.

The reason why companies have to choose this strategy is because relying too much on China poses a great deal of risk. At the same time, markets outside of China also carry their own pitfalls as many are not yet mature enough to fully replace the country as a viable sourcing market. Choosing alternative markets to mitigate the risk of relying on China also means potentially compromising on quality or efficiency. As a whole, companies are currently in a bind as to which market should be prioritized. This is demonstrated by the near parity among the three surveyed regions as places of choice for new sourcing activities in the last 12 months.

When asked about their future sourcing destinations, Southeast Asia and Europe will outcompete China in terms of attractiveness. Whether or not this trend will be realized in the future will be highly dependent on both the regions' ability to develop and meet sourcing demands as well as companies' willingness to adapt to sourcing environments different from China's. There is no definite favorite between Europe and Southeast Asia. The ultimate decision on which market to choose depends on whether the company is mostly motivated by logistics issues or cost-related issues, as both markets hold their respective strengths and weaknesses.

The international trade disruptions between 2020 and 2022 have prompted businesses to seek alternative sourcing destinations. In addition, the changing customers' sentiments and regulations regarding supply chain sustainability also prove to be effective factors in driving companies to become increasingly concerned about their suppliers' sustainability performance. Despite these developments, there have been some glaring gaps in companies' awareness regarding carbon data footprint data when compared with fair labor and corporate integrity data, matters that are important to the companies and their workers. Such a phenomenon indicates a certain lack of concern about sustainability issues that are not directly relevant to the respondents.

Overall, there is no single answer about which one location is unanimously superior to the others. Having a sustainable supply chain and diversified supplier base is nonetheless a crucial risk mitigation strategy. Setting up new sourcing activities in additional market/s is of high importance, but to which extent a relocation is necessary depends on the unique predicaments of one's own company. Thus, there is no "one-size-fits-all" solution for the best sourcing strategy.

- ARC Consulting recommends companies conduct a thorough market analysis on potential alternative sourcing markets, to optimize any new sourcing activity in the region and select the destination that is the most suitable for one's specific needs.

- Companies should assess their current sourcing activity and supplier base to identify areas of improvement and fully understand which aspects could benefit from complementary sourcing destinations, and which would benefit from relocating.
- Companies should create a short- and long-term sourcing plan, using an end-to-end perspective on customer demand, sourcing and manufacturing, and trends across regions as part of the supply chain decisions.
- Companies should also adopt a more comprehensive approach to supply chain sustainability that covers not only fair labor and corporate integrity matters but also carbon footprint.

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