Global Sourcing Shifts

*Have changing economic and political climates made your sourcing strategy obsolete?*

*By Becky Partida*

Global sourcing is a complex endeavor that involves more than just finding the lowest price for materials. When engaging in global sourcing, company leaders need to consider factors that span the entire range of the procurement process — maintaining a global sourcing strategy, identifying and evaluating suppliers, receiving goods, evaluating the delivery and managing the supplier.

Organizations also must consider that the global situation can change. Managers need to regularly revisit their sourcing strategies, maintaining the best value over time. If your organization has not evaluated its global sourcing strategy lately, fast-changing economic and political climates should motivate you to ask, “Is it time to take another look?”

The research offered by APQC on best practices and performance benchmarks and the advice of industry experts provide valuable information to consider when assessing the value of a global sourcing strategy. Those experts include Matt Gersper, president and founder of the sister companies CUSTOMS Info and Global Data Mining (CiGDM); Harry Moser, chairman emeritus at GF Agie Charmilles; and Vishnu Sukumaran and Jim Geisel, directors at the advisory firm KPMG LLP.

**External Factors Affecting Investment**

Gersper identifies the following factors that can influence the investment required for a successful global sourcing strategy:

- Correct classification and documentation for materials leaving or entering a country.
• Requirements by other governmental agencies for materials entering a country.
• Foreign inland transportation costs and time, as well as foreign customs processing time.
• International transportation costs.
• Domestic customs processing time and inland transportation costs and time.
• Post-entry customs issues and delays.
• Additional costs in duties, taxes, and fees associated with importing materials.
• Changing variables and trends for a particular material.

The influence of each of these factors can vary based on the materials ordered and the timing of the order. For example, in January 2012, the World Customs Organization released new amendments to the Harmonized Commodity Description and Coding System that changed the classification codes for many materials. Changes such as these have the potential to delay customs processing or impact tariff rates.

In addition to the external factors that can affect a global sourcing strategy, organizations should also consider how global sourcing can affect internal procurement processes.

Effects on Procurement Processes
Data from APQC’s Open Standards Benchmarking in procurement provides valuable insight into the procurement costs associated with global sourcing. Benchmarking participants indicated the percentage of their purchases sourced from other countries. For its analysis, APQC divided participants into groups based on the extent to which they source globally. APQC then looked at
companies reporting less than 1 percent of purchases sourced globally and those reporting more than 40 percent sourced globally.

APQC’s data indicate that organizations sourcing globally have overall higher costs associated with appraising suppliers and ordering materials. For organizations conducting more global sourcing, the median cost for appraising suppliers is 48 cents per $1,000 in revenue. These organizations also report that ordering materials costs them $1.85 per $1,000 in revenue. Among organizations conducting less global sourcing, the median cost to appraise suppliers is 33 cents per $1,000 in revenue and the cost to order materials is $1.21 per $1,000 in revenue.

These results indicate that organizations conducting more global sourcing should devote time and resources to researching potential suppliers, developing a method for evaluating those suppliers and conducting any necessary supplier training and certification. This is especially true when suppliers are located in still-developing countries; they may need additional mentoring.

The organizations conducting global sourcing also report dramatically higher systems costs related to the processes of appraising suppliers and ordering materials. (See Figure 1.) These higher systems costs can be attributed to the sophisticated electronic systems needed to order from suppliers in other countries. Benchmarking data indicate that organizations conducting more global sourcing devote fewer full-time equivalent (FTE) personnel (34.93 FTEs) to ordering materials per $1 billion in purchases than organizations conducting less global sourcing (47.62 FTEs). Global sourcing requires more complex electronic systems. Once they are in place, organizations require fewer full-time personnel to purchase materials.
Organizations with heavy global sourcing report more streamlined procurement processes and buy primarily from strategic suppliers. (See Figure 2.) These organizations have significantly fewer active suppliers in their supplier master file per procurement FTE (3.96) than organizations conducting less global sourcing (77.88). The high global sourcing organizations also report a higher annual purchase value from certified suppliers: 80 percent of their purchase value, compared with the 70 percent reported by low global sourcing companies.

*Figure 1. Systems costs for key procurement processes.*
In addition to the procurement costs associated with global sourcing, organizations should also consider how global sourcing affects the quality and timing of materials received from other countries. Within APQC’s Open Standards data, organizations conducting more global sourcing report slightly lower percentages of orders received on time, orders received complete, and orders received damage-free based on all orders received. (See Figure 3.) Ordering from greater distances appears to negatively affect both the quality and timing of deliveries. An organization needs to balance such impacts against the obtained benefits of global sourcing.
Given the many internal and external factors contributing to the cost of global sourcing, how can an organization determine whether its current global sourcing strategy offers the best value? Identifying the full sourcing investment associated with a particular country can be difficult. Gersper emphasizes the importance of evaluating the total landed cost of purchasing globally. This includes not only the cost of the material itself, but also the shipping costs and any duty fees and taxes that are assessed by the source and destination countries. He also encourages the use of predictive analytics, citing the abundance of data that can help companies determine which countries have the highest sourcing demand as well as the lowest duties and taxes.

Sukumaran recommends that organizations use a total cost of ownership (TCO) model to compare the cost of their current sourcing strategy with the potential cost of sourcing from different countries. Organizations can then use the comparison to determine which strategy offers the best value. Moser developed
a practical tool for calculating the total cost of ownership. The tool provides a method for a company to calculate the total cost of ownership for offshore manufacturing operations for an item as well as to make a five-year cost of ownership forecast.

Figure 4 lists the various factors considered in Moser’s tool. The list is split into sections that are calculated individually and then combined to obtain the TCO. By calculating the TCO for an item and estimating how that cost will change over five years, an organization can gain greater insight into whether it should immediately adjust its global purchasing strategy to obtain the best value over time.

Geisel notes that supply chain risk can ultimately affect an organization’s bottom line, so he encourages organizations to have a plan for the unexpected, including disruptions to the supply chain as a result of natural disasters, customs delays, or geopolitical changes that may affect the course of “normal” global trade. He recommends that organizations revisit their global sourcing
strategies at regular intervals to ensure that they continue to receive the full anticipated benefits and are aware of any changes impacting category execution. Geisel also recommends that organizations look at their sourcing decisions from a global perspective, aligning TCO and risk. Changing or adjusting sourcing strategies may be perceived differently by suppliers in other countries. Therefore an organization should understand the culture in which it is working to best manage the trading partner relationship.

**Conclusion**

Organizations should regularly conduct a thorough analysis and review of all expenses — both internal and external — that could conceivably be related to global sourcing. Organizations should also assess the potential effects of global sourcing on supply chain risk. These factors may change depending on the material to be sourced or the industry, but they must be considered to determine whether the organization’s current global sourcing initiatives still make sense. In addition, organizations should stay informed about any political and economic changes that may affect their bottom line and adjust strategies as necessary. Taking a proactive stance can help companies make smarter purchasing decisions.

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