

BME China Sourcing Conference 2009

Best Value China Sourcing: Optimizing Price, Quality and Lead Time

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Conference Report

Despite current economic difficulties across the world, global sourcing will continue to be a core element of corporate strategies – and China will continue to play a major role. Neither the current economic crisis, nor the constantly high raw material prices seem able to jeopardize the robust condition of China's economy. “The Chinese engine is running so powerful that supply situations worldwide are getting tenser every day,” said Dr Juergen Marquard, President of BME, at the beginning of the 2009 “China Sourcing Conference”. China is virtually buying up other markets.

At the same time, it will become an ever more important sourcing market for international companies. China is a market that still poses a number of challenges and risks. Buyers therefore need a clear strategy in order to successfully purchase from China. During the conference, a number of experienced speakers talked about conditions in China and shared their experience with creating strategies for a successful purchasing operation. Purchasing strategies include organisational pre-conditions as well as the definition of clear goals. The selection of suppliers is followed by tirelessly working to develop them into high-performance companies if needed. It is equally important that a company constantly optimizes the structure and manpower of its own buying departments in China as well as at the headquarters at home.

Before 2013, up to 24 Billion Euros of procurement value will be shifted out of Western Europe, according to Frank Benkert, Project Manager of BrainNet EAC, a specialist consultancy for Supply Chain Management. “The markets that will benefit are China, India and Eastern Europe.” Meanwhile, China as a sourcing market is slowly evolving as companies are moving up the value chain. China's exports to the EU-27 and Turkey are increasingly dominated by technology-intensive commodities. Their share of exports climbed from 55.9 percent in 1998 to 70.5 per cent in 2008, according to Benkert. He expects the government will continue to promote technology. This includes enhanced legislation in this field. Buyers can support local partners to develop from high-volume parts suppliers into medium-volume systems providers.

China is still a source of raw material and primary products as well. One of the most important materials is steel. This is a sector which is strategically important to China but plagued by large overcapacities caused mainly by its large number of unsustainably small and dirty steel mills. “80 percent of China's national output is generated by the top 100 steel mills – out of some 700,” said Thomas Kruegger, China and South East Asia Delegate for Kloeckner & Co, a producer-independent multi-metal distributor. Construction takes up 57 percent of locally made steel, 16

percent go to machinery, and a further six percent to the automotive industry. China's top ten producers such as Baosteel or Hebei Iron & Steel are well-known and have up-to-date machinery. Still, they are not always willing to use this machinery to cater to clients' special requirements. The crisis may help to change attitudes, Kruegger assumes, as competition intensifies. Consequently, he also expects improvements in quality after the crisis. On the other hand, the crisis has caused erratic price movements. In Kruegger's view it will take the price another six months to find a final level.

The crisis has also severely affected logistics operations and rates. When the crisis hit, production and supply chains could not immediately stop, as Carsten Pfuhl, Director of Asia Logistics for Continental in Shanghai, explained. Companies started to focus on their working capital and protected it. They reduced inventories and tried to retrieve cash quicker while at the same time delaying payments which created a high level of mistrust throughout supply chains. At the same time, the export slump led to overcapacities in the shipping industry and an ensuing freight rate war. Capacity was then artificially reduced which resulted in very high utilization rates when demand recovered. This, in turn, caused increasing freight rates, delays and re-routings. Flexibility is key for doing business in Asia, according to Pfuhl. This is due to occasional chaotic customer call-offs or growth-driven demand fluctuation. It is therefore essential to do systematic forecasting and permanently track market development.

It is common knowledge that choosing the right suppliers is essential for the start of a successful procurement operation. But sometimes it is not possible to find a supplier which can instantly fulfil all the buyer's requirements. The best one may have been chosen by the competition or may be too expensive. In that case buyers need to choose a compromise candidate and develop it, according to Guido Maune, Vice General Manager and Director of Supply for ZF Drivetechnik in Hangzhou: "That starts right after the selection." In a case study, Maune recalled the time-consuming but ultimately successful development of an underperforming sub-supplier in the course of a project to source four sheet metal parts for an axle system within China and deliver them to a ZF plant in Australia. A site visit to the sub-supplier revealed backward conditions; the factory was dirty, there was no production planning, presses were not arranged in a systemic order which led to delays in the process. Dirt in the presses reduced the tolerance of the sheets produced. Consequently, ZF established a team of experts at the sub-supplier. They analysed processes and reported detected problems. ZF worked hard with the sub-supplier's top management to create an understanding of the problems, helped to arrange training sessions there and installed a new payment system presenting incentives for employees. As a result, the sub-supplier has greatly improved its performance. Maune's conclusion is that top management of a supplier needs to be involved if there is to be a sustainable change for the better. And, he advises: "Don't avoid hard fights with the company. Be friendly, but very insisting."

Dr Ralf Augustin, Vice President for Purchasing Strategy at J.M. Voith in Heidenheim, explored his company's strategy of bundled purchasing. With purchasing volume as high as 60 percent of sales, optimizing the sourcing strategy has a big impact on profitability. Yet, this was a challenge in the very decentralised structure of Voith's, where less than five percent of its suppliers are shared by three or more Group Divisions. Voith launched a Group-wide management of material groups with bundling potential. Nine Non-Production-Material and three Production-Material commodity centers were established, and policy-making authority given to Central Strategic Purchasing. Voith deployed purchasing targets in cost, quality, time, efficiency and transparency in all Group Divisions. The ongoing implementation of this strategy in China initially focused on quick wins for Voith – for example on material groups for which competence centers were already in place - such as logistics, IT/telecom or workwear, according to Augustin. In communication, for example, it was then found that each entity had different contracts with different service providers, providing different tariffs and discounts. After cost breakdowns, benchmarking and joint negotiations of all

entities, Voith managed to reduce cost by 30 percent and now has new contracts with one price level for all Chinese entities of the company.

A global setup including a sourcing facility in China is one important success factor, according to Wolfgang Gallet, Global Category Group Manager for Interconnections at Nokia Siemens Networks (NSN) in Shanghai. Other factors include international experience of both the suppliers' management and the internal sourcing team, close cooperation with local suppliers as well as case-specific supplier management. NSN's China Sourcing Hub applies the company's Supplier Base Management system to China which provides a standardised procedure for dealing with suppliers along the way from first contact to "Potential Supplier" status to "Approved Supplier", and eventually "Preferred Supplier" for top performers. "It is more important than elsewhere to constantly monitor suppliers' performance", said Gallet. Management responsibility, human resources and environmental management, and quality or adherence to Intellectual Property Rights are constantly evaluated at NSN's existing suppliers.

But before a company gets involved in China, it needs to do its homework at the headquarters, as Thomas Rohrbach, CEO of Staufen, an implementation oriented consultancy in Shanghai, warned. It needs to clarify what it wants to do, when, where and with whom. It needs to check which commodities are most suitable to be the first ones sourced from China – ideally not the most complex ones. And it needs to calculate how much it would like to save by buying in China, and to determine the level of quality needed. "Proven exporters are expensive", Rohrbach cautioned. A successful buyer company knows which material is available in China and presents clear and updated technical documents for the products it wants to buy - in Chinese or at least proper English. A sourcing team grows over time. "But it is a smart approach to hire one sourcing engineer a year before setting up the sourcing enterprise in China", Rohrbach recommends. Later a company needs to decide who will run the operation: An expatriate knows the headquarters and the products well while an experienced local has deal-making know-how and understands how Chinese suppliers tick. Personal integrity is a must as corruption is widespread in China.

Bribery doesn't end at the gates of multinationals operating in China. "And it is most common in purchasing departments", said Ben Wootliff, Director of Corporate Investigations at the risk consultancy ControlRisk in Shanghai. While government corruption is considered serious, kickbacks are commonly seen as a business norm. In order to combat corruption among employees, a company first has to create a culture in which fraud and bribery are not tolerated. A robust compliance system includes ethics codes, hotlines, disclosure rules, all enforced on a high management level. Also, employees in China need training about what constitutes an act of corruption. Another safeguard is effective due diligence on people who make decisions, according to Wootliff: "The screening alone deters corruption." Chinese law stipulates that any bribery act by employees constitutes an act by the business operator, i.e. the company, according to Rainer Burkardt, Partner at the law firm Squire, Sanders & Dempsey in Shanghai. The Anti-Unfair Competition Law forbids managers to bribe in order to sell or purchase commodities. "A bribe includes secretly offering rebates off the book," Burkardt explained. Corrupt practices in China can also be investigated under the US Foreign Corrupt Practices Act.

Empowering the sourcing community: BME database on suppliers in China

BMEQualitySourcing.com is a new database that connects quality suppliers in China to buyers around the world. Accredited users will be able to filter suppliers according to their product range, material groups, technical specifications, production capacities, international experience, certifications and many more criteria. For listing at BME QualitySourcing.com, supplier companies have to fulfil at least one of four criteria, according to Olaf Holzgreffe, Global Project Manager of BME QualitySourcing.com: Certificates (such as ISO) issued by international certifiers, valid audits by European buyer companies, existing supplier relations with companies in Europe, or a TÜV

Rheinland STAR or Quick-Check by BME or TÜV. For buyers, this concept creates an easier and faster identification of capable suppliers, comparability of content as well as an acceptance for usage of database content in general while it is an efficient platform for suppliers to promote their capabilities. BMEQualitySourcing.com is powered by SupplyOn, one of the world's largest providers of web-based services for supply chain management in the automotive and manufacturing industry.