

## 7 Deadly Sins of Global Sourcing

Reasons for sourcing from abroad could be anything between availability of material to lower cost, but small and medium size businesses feel it necessary to go this route in order to remain competitive. However the road to global sourcing is littered with potential pot holes that need to be avoided or overcome.

Helping SMEs reduce cost and smooth supply chain by sourcing metal engineering components from Asia, Asco's experience allows us to present the 7 deadly sins of global sourcing. While the sins are not morally or ethically wrong, they can be financially punishing.

### The Sins

#### **1. Inadequate planning and risk mitigation**

It is very important to be clear to yourself about the position that your company is in and also understand the consequences of sourcing from abroad. From a financial viewpoint sourcing directly from abroad is essentially a balancing act between profitability and cashflow. Yes, if implemented correctly, the cost-per-item will reduce, but it will also result in higher inventory and thus a greater strain on cashflow.

So what are the things to plan for and mitigate against?

- a. Increased inventory: Sourcing goods from distances afar means much longer lead times. For example Asia is approximately 4-6 weeks away by ship. Thus your supply chain plan should reflect an appropriate increase in stock holding and transit inventory. This is especially true for items that are critical to your operations. Working on a just-in-time basis while importing from Asia is not an option as there are a number of variables out of your control that can cause delays and increase to time to delivery. Real reasons that have caused delays in the past include: customs computer failure; adverse weather conditions; haulage workers' strikes; lack of freight space; shipping accidents and of course ash clouds.
- b. Warehousing space: Not only inventory costs, there will be a requirement to have greater warehouse space.
- c. Which parts to offshore?: Although all labour intensive parts are candidates for sourcing from low cost countries, you may not want to outsource some parts for the following reasons.
  - Parts for which you need to be flexible in terms of your reaction to changes in demand. Such parts may be best for local sourcing. Ideal candidates to offshore are those that are used in high volume and have long shelf life.
  - Parts which are unique to you and give you a competitive advantage.

Even if they are the most likely candidates for outsourcing, do not start your foray into global sourcing with critical parts. Learn from mistakes made with non-essential parts first.

- d. Quality control: You are likely to have the same quality problems with a supplier down the

# ASCO FIXINGS LTD

MANUFACTURER OF METAL ENGINEERING COMPONENTS AND ASSEMBLIES

Birmingham | London  
Tel.: 0121 553 1177 Fax: 0121 553 1199 E-mail: info@ascifixings.com  
[www.ascifixings.com](http://www.ascifixings.com)

road as you will with a supplier in Delhi, Kaohsiung or Shanghai. However sorting out those problems is a lot more complex and expensive from 6,000 miles away. It is always cheaper to sort out quality issues before goods leave their destination rather than after you receive them. So, for starters, ask for samples and have goods inspected independently until you build confidence in your supplier. Go into as much detail as possible early on; for example, do not leave packaging as an afterthought as the goods will be subjected to a lot of bumps along the way or find out about pallet sizes and fumigation requirements, if any.

- e. Prepare to learn: This includes everything from shipping terminology (especially because it is often cheaper to arrange own transport), requirements for customs clearance, getting visas, trade regulations, cultural differences and different country business etiquettes.
- f. Quantity: Often it is the case that in order to get the best price for the goods being purchased that you will need to order large quantities. Smaller quantities will be more expensive both for production and transport.
- g. Payment terms: Until a rapport is established with your supplier/s (and assuming the credit crunch loosens its hold), payment terms will be before shipment of goods. This will put added pressure on your cashflow.
- h. Loss of intellectual property: For product designs that are unique or patented, it is important to be extra careful in your planning. While you are advised to carry out all the legal safeguards, being at a distance means that if the supplier sets themselves up as a competitor, you may not have the resources or patience to jump the necessary legal loops. One way around for such parts may be to only source the parts and do the final assembly locally.

## 2. Only consider product cost

While very difficult to define accurately, it is important to get a hold of the true overall cost of product acquisition. There are increased operational and administrative costs when sourcing directly from abroad, and these costs need to be taken into consideration early on. Costs to consider include logistics, administrative, transit and stock inventory, goods insurance, increased communication, travel, quality inspection, procurement employee time, to name but a few. Not only these, but intangibles such as reliability, ease of doing business and trustworthiness are costs that should be considered in equal terms.

## 3. Not going beyond component sourcing

Although raw materials can be cheaper in Asian than in western countries, it is the large labour cost disparity that provides the main savings when buying from a low cost country. So instead of only looking at sourcing components, try to outsource some of the labour intensive assemblies or even redesign some of the manufacturing processes with low cost sourcing in mind.

## 4. Be a desk potato

One thing is for sure, sitting in your local office and communicating over the phone or email is not

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going to get you the best value for money. In order to find the right supplier, face-to-face meetings and factory visits are essential for a number of reasons, least:

- Due diligence – It is not enough to visit supplier website and see their ISO accreditations. You need to assess your supplier using at least the following criteria.
  - I. Capability – Websites can be deceiving. Only by visiting the factory will you be able to answer some of these questions. Does the potential supplier have the appropriate manufacturing and testing equipment? Do they have any accreditations? Is there a support industry close by (e.g. for painting or plating)? Do they have qualified engineers? What are the other customers they deal with and products they manufacture? What is the financial status of the supplier?
  - II. Capacity – Can they scale their business along with you?
  - III. Compatibility – Is the potential supplier the right size and do they have sufficient focus on quality for your components? The supplier may be too small for your needs or too large, and hence not give you much priority.
  - IV. Attitude – The supplier may not yet be up to your requirements, but are the willing and hungry to invest their time and money in order to get the order? Do they have the desire to learn and be flexible? Are the willing to invest time and money in order to develop a long term relationship.
- Building trust – All the contracts in the world may not help you if things go wrong. It is thus vital to take time to build a trusting relationship with your supplier, so that at a time of crisis you work together to solve the problems rather than play a blame game.
- Better negotiating power – The way to get the best price for a product is with a personal meeting. In most Asian cultures it is customary to socialise in the evening with business partners as a means of getting to know each other better.
- Bridging cultural gaps – A ‘Yes’ to people from different cultures does not necessarily have the same meaning as what you understand it to be. Certainly there is a language and cultural gaps, but with increased understanding of the suppliers’ culture, you can reduce misunderstandings. Once you start working with your chosen supplier, regular communication and contact is important to learn about any potential issues early on.

## 5. External factors will remain the same

Growth in Asian countries is much higher than in Europe, which can have sudden or dramatic affect on the following.

- Currency – Use currency hedging to reduce the currency risk
- Shipping freight costs – Freight costs reduced significantly in 2009 and then increase by between 250-400% in a matter of six months.
- Labour costs – Due to new labour laws and high demand, labour costs in Asian are increasing quite rapidly
- Government tariffs and subsidies – Be aware of reducing Asian government subsidies and

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also European government tariffs (such as the anti-dumping duty for fasteners from China).

## 6. Assume

Culture differences, different time zones and distance mean that there is a distinct possibility of miscommunication. So a good way to make sure that the t's are crossed the i's are dotted is not to assume. Do not assume that the

- Supplier understands your verbal explanations. Write and describe ideas in detail.
- Paperwork will be completed according to your standard. Show examples of quality of documentation you require.
- Delivery will be on time just because that is what was decided at the start of a project. Keep on top of status.
- Quality of the mass produced part will be like the sample they provided. Make quality checks.
- Packaging will be as you have in your local market. Provide specific instructions.
- Prices will remain the same for the next order.
- Supplier provides adequate goods transport insurance.

## 7. China is the only low cost country

While China is clearly the largest low cost country of choice, there are other developing countries that may be more suited to manufacture your desired products or more favourable to your business culture. So here are some points to take note of.

- Low cost sourcing is a moving target and you may have to change source locations over time. For example, since the introduction of anti-dumping duty on fasteners from China, Vietnam is a good source of low value fasteners.
- UK imports from Commonwealth countries carries no duty for most metal products, while those from China carry a duty of 3.7%.
- Some materials and processes are better prices in one country over another. For example, galvanizing is cheaper in India than in China.
- Different countries may have specialisation with products that you require. For example, development of complex and high quality fasteners is quicker in Taiwan.
- English is prevalent in most industrial locations in India, Taiwan and Malaysia.
- Chinese suppliers much prefer making a transaction in US Dollars over British Pounds. This is not the case with other developing countries.

With over a decade of experience sourcing goods from Asia, Asco can help you overcome most of the obstacles mentioned above. For more information, feel free to contact Asco Fixings.