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*Mobilising domestic
demand in China*

Strategy

The growing importance of supplier
collaboration in Asian markets



This first part of a two-part feature discusses root causes of Asia sourcing difficulties for Western companies and outlines guiding principles for maximising the value of relationships with Asia-based suppliers



By Jonathan Hughes and Jessica Wadd

For many years, global companies have been shifting spend to suppliers in low cost regions, especially in China and other east Asian countries. Up until very recently, the primary driver was the significant labour arbitrage opportunity. With wages in much of Asia - particularly China, India, Malaysia, Vietnam, and the Philippines - a fraction of what they are in developed Western countries, many goods could be manufactured at significantly lower cost, and similarly, many services, from call centre support, to software development, could be sourced at significant savings.

Results for many companies have been mixed, however. Quality problems have been common, and costly. Moreover, many underestimated the transportation costs and logistical complexity associated with a global supply chain. The net result is that actual savings realised by organisations were often a fraction of what was projected. Moreover, when negative impacts to revenue associated with supply chain difficulties are factored in; the net impact of shifting significant sourcing to low-cost Asian suppliers has actually been negative

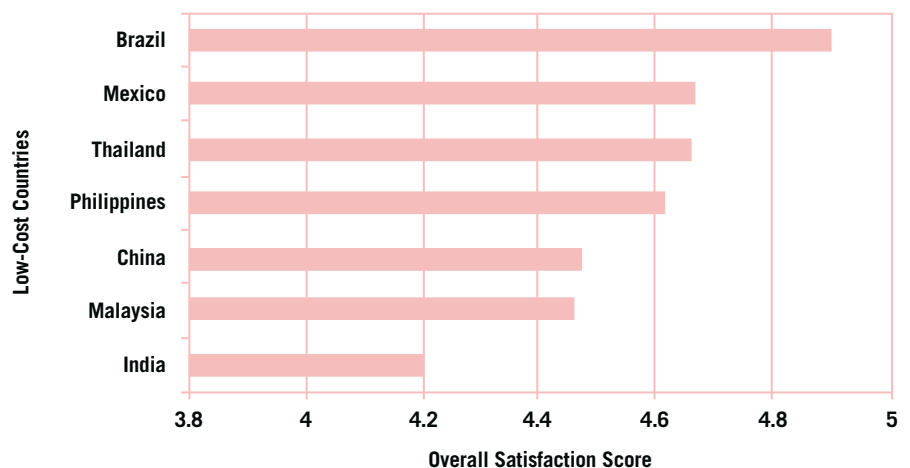
in many instances. In a 2007 study, nearly 20 percent of respondents reported that the costs of sourcing from China can exceed the savings.¹

During the past years, several major Western brands such as Mattel, Apple, and Iams have endured costly and highly publicised problems caused by their Asian suppliers (e.g., dangerous levels of lead in children's toys, poor treatment of workers, and pet food contamination and associated pet fatalities).

Moreover, when compared to the performance of their suppliers in other low cost countries, Western companies report being significantly more dissatisfied with their suppliers across Asia - with Thailand being the most satisfactory, and India the least.²

This gap is recognised by suppliers as well. In a 2009 global study of customer-supplier negotiations and contracts, we found that suppliers in Asia report that they are only able to deliver, on

Overall satisfaction with the most popular low-cost countries' suppliers



average, 59 percent of the total potential value of their contracts with customers, compared to European and North American suppliers who reported delivering more than 67 percent of potential total contract value.³ Not surprisingly, these suppliers have some very different perspectives on reasons for the erosion of value than do the companies that source from them. In general, suppliers laid much of the responsibility at the feet of their customers, citing unclear requirements, frequent changes to specifications, inaccurate and late forecasts, and failure to provide adequate staff access and support as primary explanations for under-delivery.

Asia sourcing difficulties

Sourcing from suppliers in many Asian countries entails inevitable challenges - geographic distance coupled with inadequate communications and logistics infrastructure, cultural differences, and immature legal and regulatory frameworks, to name a few. Nonetheless, many companies have been highly successful sourcing from Asia.

Indeed, our research and experience working with companies on global and low-cost region sourcing initiatives indicate that these structural challenges are tractable, and that the root causes of failure have a great deal to do with the manner in which companies build and manage (or fail to) relationships with their Asia-based suppliers.

Far too often, Western companies have taken a short-term and highly tactical approach to dealing with Chinese and other Asian suppliers. They have focused on unit-price, rather than carefully analysing total costs of acquisition and ownership, or considering supply costs in the broader context of profit margin contribution. They have given lip service to quality, environmental sustainability, responsible labour practices and the like - yet through their actions have sent a clear message to suppliers that cost is all that truly matters, and have expended little if any effort working jointly with suppliers to reduce and manage costs through greater efficiency, rather than cutting corners.

Most fundamentally, they have viewed and treated suppliers like vendors rather than business partners. Few Western companies have invested in truly

understanding their suppliers' business models, their capabilities and limitations, or their supply chains. Nor have they built strong interpersonal relationships between management teams, characterised by a high degree of mutual commitment, respect, and trust. Instead, when production or service problems arise, supply chain managers and senior executives too often blame suppliers instead of working with them to diagnose and address difficulties, and frequently simply switch suppliers, rather than looking at how their own actions might contribute to supply problems (or conversely, to more successful outcomes).

A rapidly changing context

Increasingly, a number of factors are converging that require a fundamental re-thinking of Asia as a supply market. As economies in the region have matured at an unprecedented pace, Western and multinational companies need to begin seeing Asia-based suppliers not (simply) as a source of cheap labour, but as a source of talent (especially in technical fields such as engineering), and of innovation.

China and India alone produce more than one million engineering graduates each year, as compared to just 70,000 in the US and 100,000 in Europe.⁴ In addition, while labour arbitrage opportunities in the region will not disappear any time soon, they are already diminishing and will continue to do so as rising affluence drives continued wage increases.

Moreover, in 2010, more than 30 percent of global growth in consumer demand is expected to come from China.⁵

As countries in Asia rapidly become wealthier, the region is increasingly the major market growth opportunity for many companies (and not only for major multi-nationals). Asia-based suppliers are essential partners in helping companies from other regions enter and expand their presence in Asian markets. Their relationships with local distributors and government agencies and officials, and knowledge of regional consumer needs and preferences, are invaluable assets. But leveraging them to support go-to-market efforts requires a new and more collaborative approach.

Guiding principles for maximising the value of Asia-based supplier relationships

1. Invest for the long-term

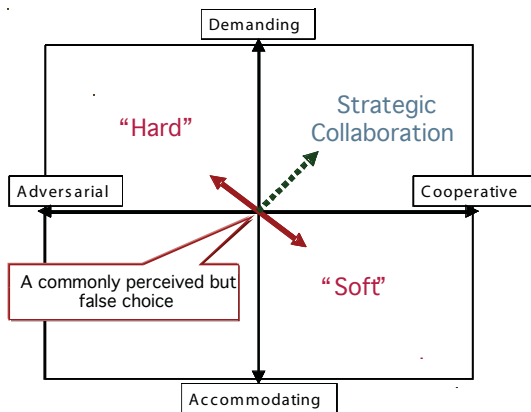
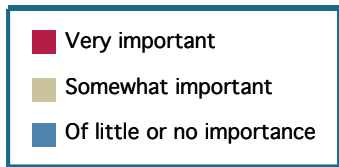
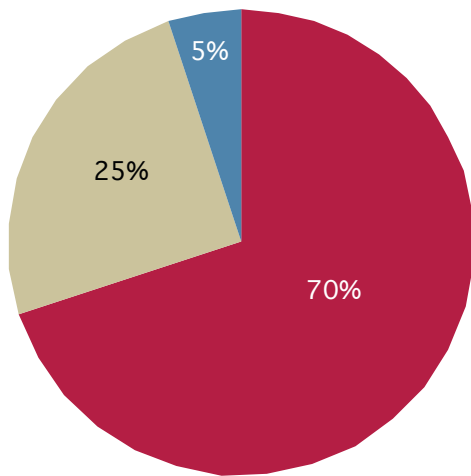
As noted above, Asia represents a huge opportunity, both as part of a global supply chain, and as a huge and growing market. But doing business in Asia is also fraught with risks and challenges. Consequently, companies should approach sourcing initiatives in the region in a truly strategic fashion. This means creating multi-year plans, committing sufficient capital and human resources, and having the management discipline and patience to stay the course and learn from inevitable mis-steps and setbacks.

During the Conference Board's 2009 *Supplier Relationship Management Conference* in Atlanta, Mike Meaden, Vice-President, Client Services Procurement at IBM, shared IBM's vision for developing and managing their supply chain in Asia, and talked about their experiences to date. In a visible sign of strategic commitment, IBM moved the headquarters for their global procurement organisation to China, including the Chief Procurement Officer and other senior executives, and has expended significant resources to develop both a strong talent local pool for IBM procurement, and an extended network of Asia-based suppliers.

In addition to working with suppliers who are ready and able to meet IBM's needs, the procurement organisation is tasked with determining which nascent

“ When negative impacts to revenue associated with supply chain difficulties are factored in, the net impact of shifting significant sourcing to low-cost Asian suppliers has actually been negative in many instances. ”

How important is SRM to your company's overall success during the next three to five years?



Asian companies have the potential to make a significant contribution to IBM in the future - as suppliers, as well as joint development, innovation, and go-to-market partners - and finding ways to nurture and develop collaborative relationships with those companies. IBM invests both time and capital in these firms, reasoning that even a relatively low success rate will yield enormous returns on its overall investment.

To date, IBM has been extremely satisfied with the results. They have uncovered and begun work on hundreds of opportunities across Asia, many of which have already yielded significant benefits for IBM. They have also laid a foundation for future success as the region

becomes increasingly important as a source of sales and revenue.

2. Focus on developing and sustaining strong supplier relationships

It is a cliché, but one rooted in reality. Business in Asia is largely about relationships (both interpersonal, and organisational), while in much of the economically developed West, (and the US in particular), business is predominately about the deal. Interestingly, there has been a marked trend over the past several years amongst companies around the world to recognise the critical importance of collaborative relationships with suppliers, and the concomitant need to systematically build and sustain such relationships.

While to some, the term 'relationship management' still sounds soft or fluffy, and to others it raises concerns about becoming close to suppliers in a way that compromises objectivity and sound commercial practice, the discipline of supplier relationship management (SRM) is rapidly maturing. Properly understood, it is about balancing the twin goals of holding suppliers accountable, while also leveraging the power of collaboration, mutual commitment, and joint investments (of time, effort, and capital) to deliver sustainable advantage in the marketplace.

In reality, SRM is not truly new. As long as companies have had their suppliers, they have managed relationships with them.

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Typical approach to supplier management
<ul style="list-style-type: none"> ● Sourcing, contracting, implementation/delivery, etc - are poorly coordinated ● Interactions with suppliers are functionally silo-ed ● Focus on cost (often price) ● Primary reliance on competitive pressure ● Ignore (or try to eliminate) human side of business relationships with suppliers

Effective SRM
<ul style="list-style-type: none"> ● Consistent management of entire lifecycle of interactions with suppliers ● Cross-functional approach to working with suppliers ● Focus on total value ● Leverage the power of collaboration as well ● Consciously address & leverage human side of business relationships with suppliers

Traditional view of suppliers	Alternate view of suppliers
<ul style="list-style-type: none"> ● Suppliers are companies from whom we purchase goods and services ● Our interactions with suppliers are fundamentally zero sum ● Leverage over suppliers is the key to value ● Contracts are the primary tool by which we manage interactions with suppliers 	<ul style="list-style-type: none"> ● Suppliers are a source of knowledge, expertise, and assets that we can leverage to gain competitive advantage ● In a world of competing supply chains, our success is tied to that of our suppliers ● Collaboration with suppliers is the key to value ● Complex supplier relationships require formalised governance and relationship management

Unfortunately, many have done so in a haphazard, inefficient, and often counter-productive fashion.

In practice, SRM entails expanding the scope of interaction with key suppliers beyond simple purchasing and fulfillment transactions to encompass activities such as joint research and development, joint demand forecasting, sharing of strategic information about marketplace trends, and the like. SRM thus requires more effective cross-functional collaboration within the enterprise, in order to manage supplier interactions strategically, as part of an overall relationship, rather than tactically through the various organisational and functional silos that separate procurement from R&D, manufacturing, supply chain and other functions that interact with, or are affected by, suppliers.

But SRM also means systematically attending to the human dimension of business interactions - neither assuming it can be ignored, nor that it is necessarily a barrier to sound commercial practice that should be eliminated as much as possible.

Suppliers are, in fact, part of the extended enterprise. And the same management principles and insights that companies employ in trying to maximise the productivity and performance of their own direct employees are just as relevant when it comes to getting the most out of suppliers. That means treating supplier staff with the same degree of professionalism and respect as internal staff, providing regular positive feedback

(not just negative feedback when things go wrong), and making appropriate use of positive incentives (versus relying only on the threat of taking away business as a means to 'motivate' suppliers).

3. View suppliers as business partners, not simply vendors


The traditional view of suppliers as simple, fungible providers of goods and/or services is profoundly limiting. In light of global demographic and macroeconomic trends, it is essential that companies start to view their Asian suppliers as true business partners who can help them understand and navigate local markets; adapt or develop products and solutions that match local consumer and business customer needs and preferences; and contribute significantly to innovation.

More and more companies are formalising SRM programmes, and doing so on a global basis. However, results have been notably uneven. In our benchmarking of such efforts, and close examination of companies with highly successful SRM programmes, a common theme emerges. Specific tools and processes matter less than organisational culture and individual mindset. Once a company, and those individuals working in procurement and supply chain organisations, begin to see their suppliers as partners, they naturally act in ways that promote greater openness and trust, which in turn enable greater productivity, improved quality, and increased innovation.

A good example of such a collaborative

mindset in action is Akzo Nobel. At the annual Strategic Sourcing in the Chemical and Petrochemical Industry conference held in Amsterdam in February of this year, Dick Bartelse, Global Purchasing Manager for the company's power coatings business, described the company's approach to auditing compliance with its supplier code of conduct, which governs environmental sustainability, health and safety standards.

Although audits are randomly conducted to ensure the integrity of findings, Akzo places a premium on treating suppliers with respect throughout the process. Company representatives spend significant time explaining the reasons for the standards and benchmarks in the supplier code of conduct, and invite suppliers to ask questions and raise concerns. Moreover, Akzo teams actively assist suppliers in taking steps to remediate shortcoming or gaps highlighted by audits.

While such an approach is costly, not only in the time and effort required, but also in periodically disqualifying the lowest cost-supplier, it has contributed to the company's reputation and track record as a leader in sustainability, and helped Akzo Nobel develop a committed supply network in Asia that is likely to provide significant competitive advantage as competition and environmental standards in the region evolve at an increasing rate. 

Jonathan Hughes and Jessica Wadd work with Vantage Partners, a Boston-based international consultancy and spin-off of the Harvard Negotiation Project

Specific practices for maximising the performance and value of supplier relationships will be outlined in the July/August issue of Supply Chain Asia Magazine.

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- 2 Ruamsook, Kusumal. "U.S. Sourcing from Low-Cost Countries: A Comparative Analysis of Supplier Performance." *The Journal of Supply Chain Management*. 43.4 (2007).
- 3 Hughes, Jonathan et al. "Global Study of Customer-Supplier Negotiations." *Vantage Partners*. 2009.
- 4 Iype, George. "Engineering Education: Can India Overtake China?" *Rediff India Abroad*. 9 June 2006.
- 5 Yamakawa, Tetsufumi et al. "The BRICs as Drivers of Global Consumption." *BRICs Monthly* 9.7 (2009).

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About Vantage Partners

Vantage Partners, a spin-off of the Harvard Negotiation Project, is a management consulting firm that specializes in helping companies achieve breakthrough business results by transforming the way they negotiate, and manage relationships with, key business partners.

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