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Introduction

Low-Cost Country Sourcing (LCCS) has been with us as a popular topic for more than 20 years, and its strategic aims have evolved over the period due to changes in the business environment.

In the early days, first movers focused on entering unknown lands and expanding production. More and more, however, follower companies started to use LCCS as a powerful way to achieve operational improvements and strategic goals, rather than as a purely supportive function. This has given LCCS new strategic significance.

Nevertheless, when considering LCCS from a project implementation perspective, there has been too much focus on only comparing prices. LCCS has been seen simply as a supplier base restructuring exercise, while more fundamental change lies behind the scenes with the whole supply chain.

It has become clear that a well-planned reengineering process is essential to delivering the operational improvements that a competitive company requires to stay ahead. This issue of Viewpoint briefly explores some of the issues involved in the supply chain reengineering approach to low-cost country sourcing.

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First movers and followers

First movers to low-cost countries or emerging markets aimed to set up a business beach head. They were mainly tier-one multinational firms that lead in various industry sectors. Their size and capability allowed excessive spend for geographical expansion while LCCS was used to support local production.

The followers, however, often sought to add operational improvements, mainly cost reduction, to the agenda. These companies were much smaller in size and usually did not intend to explore the emerging markets. For them, LCCS was a way of improving the company's operational performance.

In recent years the development of the business environment has created better opportunities for follower companies' global movements:

- Global logistics companies have full coverage of most low-cost countries now, making long-distance supply chain management easier
- While infrastructures in low-cost countries have improved, production costs have increased, leading to higher prices for materials and components

- Local markets have grown quickly in low-cost countries, making market entry more attractive and less risky
- WTO and other international trading organisations have contributed to better multi-lateral agreements between countries relating to customs and regulations
- Sourcing from low-cost countries is generally related to external restructuring and can reduce the company's baseline spend without large-scale internal change

LCCS as a strategic tool

First movers could afford to move in first and optimise second, while follower companies were not so resourceful, hence the need for them to mitigate the risk.

Compared with bigger scale operational expansion, for example relocating production or entering markets, LCCS is an inexpensive way to achieve faster return on investments: reducing costs on direct spend (cost of goods sold) without an increase of capital expenditure is highly favoured in the current business environment.

At the same time, LCCS is regarded by many as a low-spend project for "testing the water". Through the project, firms can develop extensive knowledge of local suppliers, markets, cultures and regulations.

These first-hand learnings are the by-products of the sourcing exercise, but are extremely helpful to the firm in making decisions about further strategic moves such as market entry and production relocation.

It is certainly a worthwhile opportunity assessment before making more dramatic internal structural changes.

LCCS is also a lever in negotiations with current suppliers. Nowadays, a majority of component and raw material suppliers in developed countries make purchases from low-cost countries anyway. Some even work as agents charging more than 20 per cent mark-up. LCCS can be used to push down the mark-up, generating cost reductions with minimum effort.

The supply chain reengineering approach

With the LCCS card in hand, it is tempting to rush ahead for a quick win. However, while sourcing is just a single step in the whole supply chain, such a project will bring a profound change for the whole structure, and the decision to go ahead with it should involve careful evaluation of all potential spending from a supply chain reengineering perspective.

There is no doubt that the biggest gain from LCCS is a reduction in costs of materials, mainly generated by lower supplier overheads and labour costs and the use of alternative raw materials. Clear specification is crucial for quality control throughout the collaboration. Compromise, such as agreeing alternative designs or materials, will be inevitable.

The most important points to consider during the reengineering of the supply chain are the production and client footprints and their interaction with logistics. After redefining the value chain within an LCCS project, it will become apparent that it has to cover a much longer physical distance than in the corporation's past experience and, at first sight this might reveal that transportation costs seem to be rising.

However, in order to tackle this challenge it will become imperative to apply a collaborative process in which a company takes into account the key drivers depending on the logistics provider's models.

In most cases, companies will need to establish a local team in the low-cost country or recruit locally for the project implementation. Either approach will enhance understanding of the country concerned which will help alleviate language issues and improve decision-making and eradicate any quality concerns early in the process.

Evaluation

This concept of LCCS involves far more than simple materials cost reduction or a merely supportive function. Without proper evaluation, an LCCS project may bring disastrous results to a firm's performance. If a strategic supply chain reengineering approach is adopted and well executed, however, the firm can build significant operational and strategic advantage over its competitors.