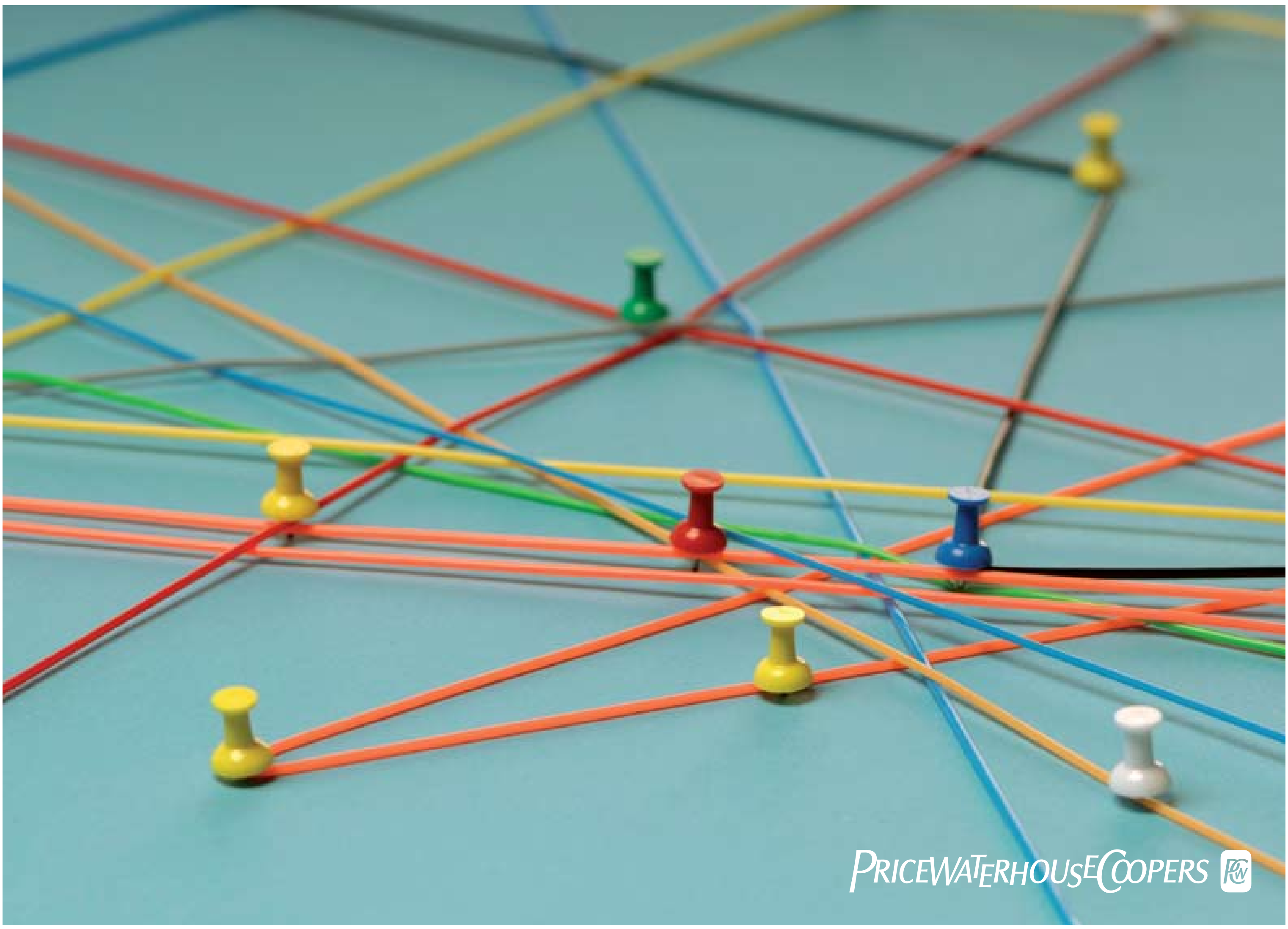
Retail & Consumer

Global Sourcing: Shifting Strategies

A Survey of Retail and Consumer Companies



PricewaterhouseCoopers

Foreword

Carrie Yu
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Global Retail and Consumer Leader

Globalisation has laid the groundwork for a profound change in the way in which companies source and manufacture products. This change has been especially marked in the retail and consumer sector, as companies strive for greater efficiency in a crowded and competitive marketplace.

The results of our survey clearly demonstrate that global sourcing is experiencing robust growth. Cost is still the major driver of global sourcing activities; however, more mature companies are shifting their focus to global sourcing strategies that create better products, minimise the impact on the environment and enhance collaborative supplier relationships. For companies involved in global sourcing, managing supply chain risk is critical and, as global sourcing grows more complex, an integrated strategy is key to success.

One of the most provocative results of our survey is the contrast between what the majority of companies said was most important – and what they actually measured and rewarded. This 'misalignment' reinforces the need for a strategy that integrates goals, measurement and rewards in order to maximise the cost benefits and drive sustainable advantage.

One of the opportunity areas that jumped out at us from the survey findings is tax. With half our respondents not taking tax optimisation into consideration in their sourcing activities, there is an obvious opportunity for greater tax efficiency.   Our report offers some thought-provoking planning questions to consider.

We would like to extend our thanks to the companies and executives that participated in our survey, sharing with us their time, their ideas and their sourcing practices. After reading the report if you have questions or would like to discuss any of the ideas please feel free to contact one of our global sourcing service team members, listed at the back of the report.

Sincerely,

Contents

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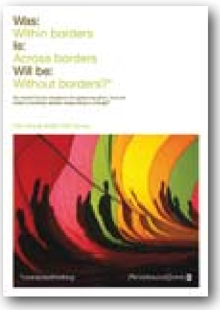
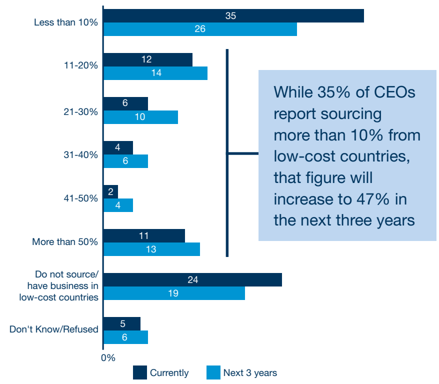
Executive summary

When we embarked on this survey of global sourcing practices we were not expecting that monumental change was imminent. However, the softening of the United States and European economies, high fuel and commodity prices, product recalls and environmental considerations have only served to reinforce our early hypothesis: successful global sourcing requires the ability to accurately measure the cost and effectively manage the risks.



PricewaterhouseCoopers' *10th Annual Global CEO Survey* confirmed that globalisation and global sourcing specifically are occupying prominent positions on the CEO agenda. Similarly, supply chain risk was cited as a key concern by consumer goods CEOs in our recently published *11th Annual Global CEO Survey*.



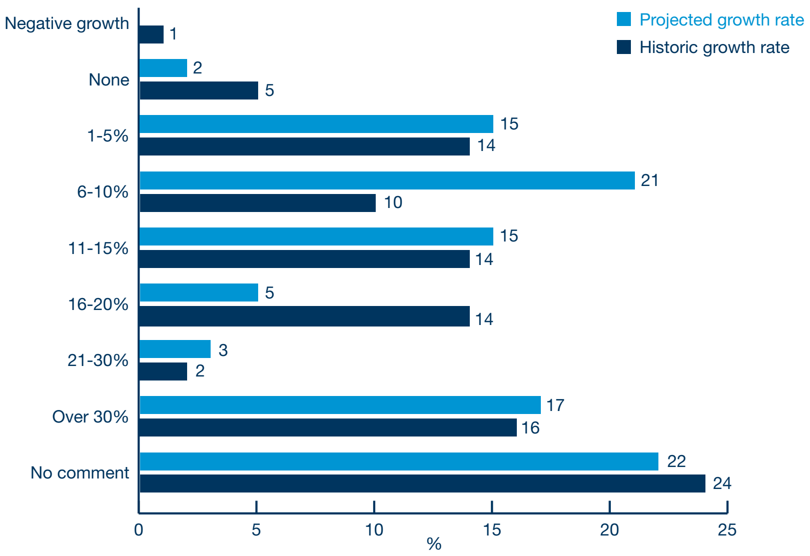
Q: What percentage of your business is sourced from, or located in, low-cost countries (e.g. Brazil, Malaysia, China & Ukraine)?
Source: PricewaterhouseCoopers Global CEO Survey 2006

Our objective with this survey of global sourcing practices was to delve deeper into the issues that these executives are facing. To that end we focused on interviewing decision makers in eight countries to understand how they were dealing with issues of global sourcing and how they saw it in their current and future agendas.

Four key themes emerge from our results.

First, *the practice of global sourcing is dynamic and growing* among the companies participating in our survey. In fact, both historic growth rates and projected growth rates are double-digit figures – 46 per cent have seen a growth rate of more than 10 per cent in the past five years. This includes 16 per cent which have seen more than 30 per cent growth. Forty per cent projected growth rates of more than 10 per cent in the next five years.

Projected (next 5 years) and historic (past 5 years) growth rates for global sourcing



Cost has rapidly become a threshold requirement to compete globally.

Second, *cost is still the key driver of global sourcing activities*. It is no longer the only compelling reason to source globally, but it has rapidly become a threshold requirement to compete globally. The practice has become so widely embraced that the cost savings generated no longer necessarily provide a competitive advantage. As respondents watch competitors reduce costs through global sourcing they have no choice but to follow suit. This point was emphasised by a number of our respondents, who felt that any cost advantage associated with global sourcing was already beginning to disappear. Bernard Chandonnay, CEO of Far Group Europe echoed this sentiment. “Because all our competitors source abroad there is little differentiating value in terms of price,” he said.

“Because all our competitors source abroad there is little differentiating value in terms of price.”

- Bernard Chandonnay, CEO, Far Group Europe

Third, *many of the surveyed companies do not have an effective procedure to measure and track their actual savings*, even though cost is their key objective. In effect, they don’t know their ‘true cost.’

Finally, as respondents look to the future, product quality is tapped as their highest priority – *but a surprising percentage is not confident that they are effectively managing the risk of product safety*. With so many of our respondents expressing some lack of confidence in this area, it seems certain that more attention needs to be given to setting quality standards and understanding where in the process things are likely to go wrong. Our respondents were even less confident about managing other risks, such as carbon footprint.

To minimise the erosion of cost benefits and drive sustainable competitive advantage companies need to address these issues:

- Creating an effective performance programme. A significant number of companies in our survey neither knew what cost savings to expect from their global sourcing programmes – nor what their actual savings were. Many companies did not have a proper mechanism to measure and track the savings from their global sourcing activities.

- Linking key goals and objectives for global sourcing to human capital and reward systems. Of our respondents who rewarded based on global sourcing goals, a majority rewarded based on cost reduction and quality – which links well with their stated objectives.

- Developing systems for measuring the 'harder to measure' costs of global sourcing – such as out-of-stocks and quality costs. Our survey clearly pointed out the contradiction between what our respondents said was important (cost) and the extent to which they track and measure the elements of that cost.

- Addressing the environmental aspects of global sourcing programmes. Many of our survey respondents did not feel confident about their ability to manage the risks of climate change and carbon footprint.

This report offers practical recommendations for handling the risks of carbon footprint and climate change, measuring supplier performance, managing risk and improving tax efficiency. All of these areas will continue to be critical ones – and the issues impacting companies sourcing globally will continue to increase the complexity of executive decisions. As new countries present themselves as viable sourcing options, so new trade incentives and restrictions, tax and environmental regulations and consumer trends will need to be carefully considered to create an effective and cost-efficient strategy.

The insights and strategies in this report will provide food for thought to help navigate the increasingly complex set of issues that are shaping the global sourcing agenda.

Background: About this survey

This survey is the result of 59 executive interviews carried out by the PricewaterhouseCoopers global sourcing service team. Our interviews involved global retail and consumer companies in eight countries: Australia, Canada, China, France, Germany, India, the United Kingdom and the United States. The executives interviewed were those with responsibility for their organisation's sourcing activities. The titles of the executives typically included supply chain director, sourcing and logistics director, global procurement director and vice president of procurement.

The companies we talked to represent a cross-section of retail and consumer organisations operating in global markets – many of them large, mature organisations. Just over half of them (53 per cent) are from retail and distribution, with the bulk of the rest coming from food and beverage (24 per cent), textiles and clothing (seven per cent), and others including fast moving consumer goods and durable goods. Our research addresses the sourcing of products and materials only. In terms of size, our respondents range from companies sourcing less than US$60 million to companies sourcing more than US$10 billion. Forty-four per cent of the companies source more than US$500 million of products globally each year.

Sourcing product outside the boundaries of their home country has almost become a prerequisite for survival.

When we began this project, we wanted to identify the major trends influencing the current and future sourcing activities of the survey group and determine the extent to which these organisations were in a position to evaluate the entire spectrum of costs and risks inherent in their global sourcing operations. Our research yielded interesting – and occasionally provocative – results.

We asked: Are organisations poised to take advantage of all the benefits of a global marketplace? Is cost still the primary driver or are other factors becoming more important? What factors are taken into consideration when forming a global sourcing strategy? And, last but not least, how able are companies to measure the ultimate results of their efforts?

With today's competitive environment and with the retail and consumer sector increasingly doing business on an international scale, for many companies sourcing product outside the boundaries of their home country has almost become a prerequisite for survival. And in the realm of global supply chains, mistakes are costly. As one of our respondents bluntly put it, "Global sourcing will either make you or kill you as a business."

What is global sourcing?

In its earliest stages, global sourcing really meant low-cost country sourcing. The simple objective was to source product or components from a country with low labour costs, thereby achieving a cost advantage – and a more competitive price. For some companies today that's still the main objective. In our view, however, true global sourcing is considerably more complex and has a more strategic objective. According to authors Monczka and Trent (1991), "Global sourcing…refers to the integration and coordination of procurement requirements across worldwide business units, looking at common items, processes, technologies and suppliers."[1]

Over the past few decades, modern technology has allowed businesses throughout the world to take advantage of global resources in ways never even thought of before. It is possible for an American company to find or set up a factory in China to make just about anything cheaper and often faster than anywhere else.

One of the most difficult things to measure in the complex series of relationships we call global sourcing is the true cost. We define true cost as those costs that can be easily measured added to those costs which are more difficult to measure, but still have an impact. Identifying all the relevant factors to be considered is one issue; capturing and quantifying the costs involved is certainly another.

"'Global sourcing' is a misused phrase. Companies based in one country and buying from the Far East … this is not global sourcing. True global sourcing is when a business manufactures and sells a consistent product globally, sourcing some or all of the product from third parties chosen to enable cost-effective and efficient sourcing, and coordinated globally."

– Head of external sourcing for a global consumer products company

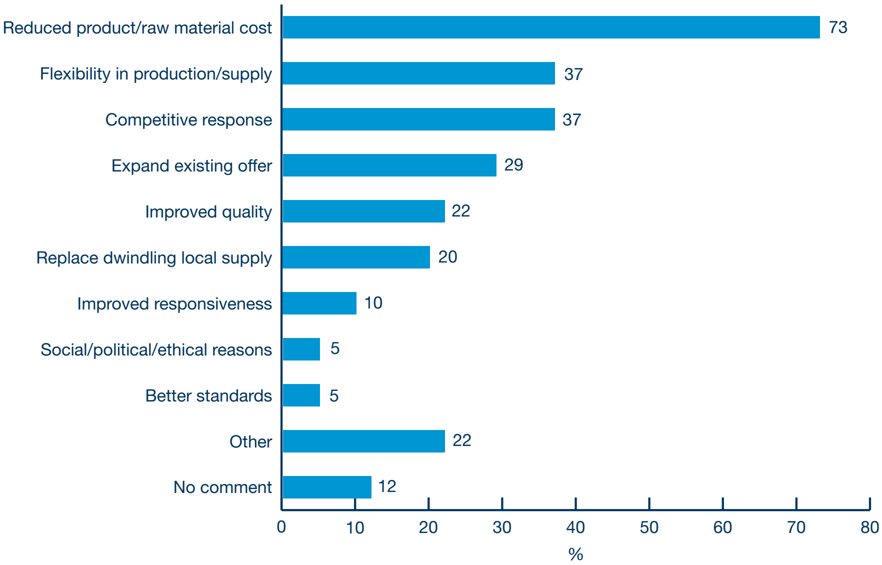
[1] Monczka, R.M., Trent, R.J. (1991), "Global sourcing – A Development Approach", *International Journal of Purchasing and Materials Management*, Vol. 27 No.2, pp.2-8.

Key themes:
Shifting from cost to quality and the environment

From our research certain themes stand out.

- Cost is by far the main driver of global sourcing activities, with 73 per cent mentioning it as their main objective. Two-thirds of respondents felt that global sourcing provided them with a cost advantage; however, there was a substantial segment (almost one-third) that believed it did not. For these companies, competition drives them to it. They feel that they aren't achieving a cost advantage, however, since 'everyone else is doing it too.'

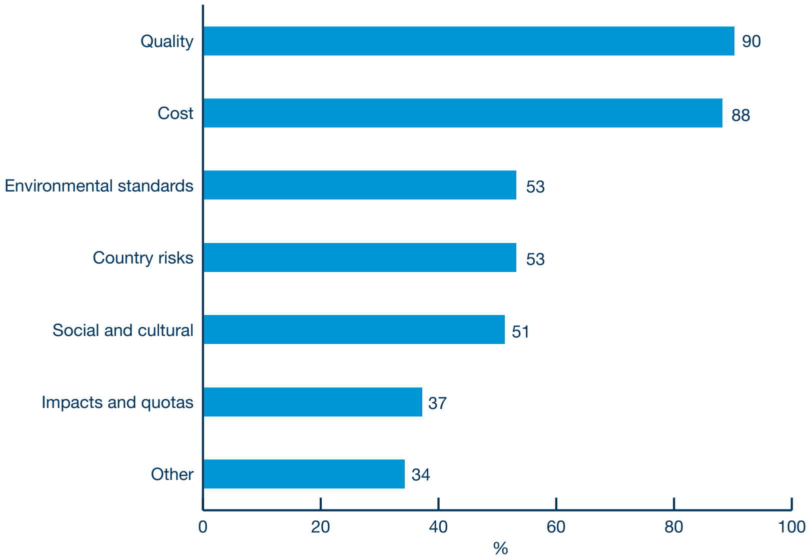
Main objectives for global sourcing



90 per cent cited quality as the single most important concern when thinking about the future. On the other hand, fewer than half these respondents said they were very confident they could manage the risks associated with product safety – a perplexing result.

- When our respondents look to the future – thinking about new sourcing strategies and locations – quality emerges as the most significant concern. In fact, 90 per cent cited quality as the single most important concern when thinking about the future. On the other hand, fewer than half these respondents said they were very confident they could manage the risks associated with product safety – a perplexing result. Given the potential repercussions of a product failure or product recall, more active steps are called for in order to manage this risk. Choosing the right supplier and applying rigorous quality control procedures are obviously critical.

Whenever you are thinking about new sourcing strategies and geographies, which of these issues do you consider?

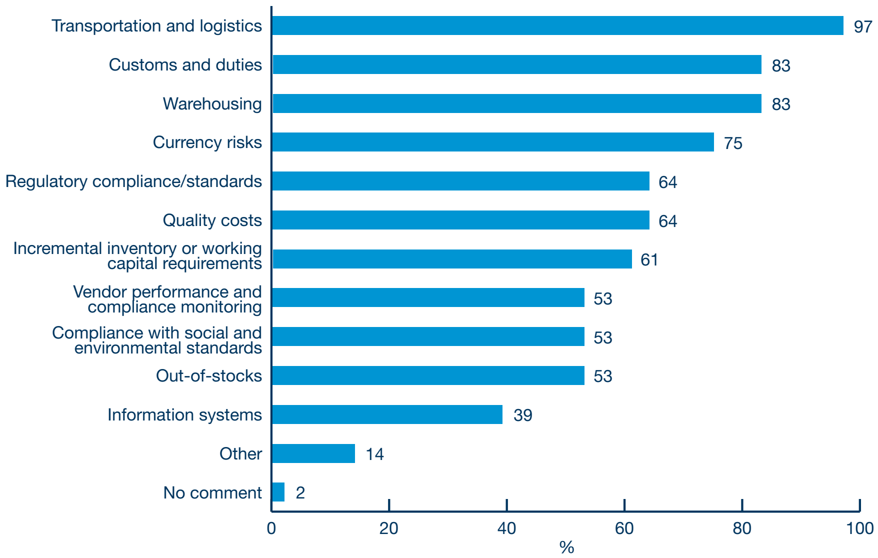


- Even though cost is the main objective for our respondents, 21 per cent of them did not know what savings to expect from their global sourcing activities. Moreover, one-quarter did not know what their actual savings were. Many companies did not have a proper mechanism to measure and track the savings from their global sourcing activities. These results show the extent to which organisations are still challenged with putting into place an effective performance programme.

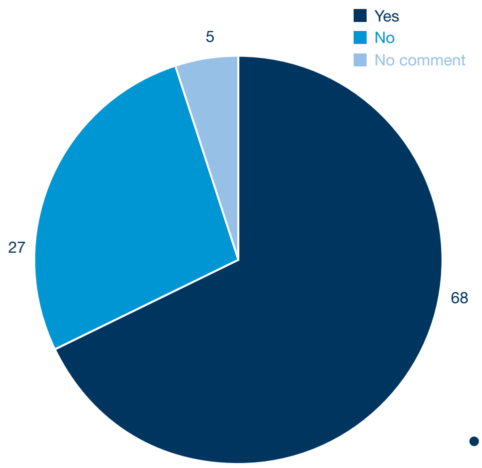
- We were interested in understanding the extent to which the companies link key goals and objectives of global sourcing to their human capital and reward systems. Two-thirds of respondents stated that employees are rewarded for their contributions to meeting the goals of their global sourcing programme. Key considerations in reward programmes are cost reduction (79 per cent) and quality (71 per cent). This ties in well with the companies' stated objectives; however, we were not able to assess the actual metrics used and the quality of reward systems in place.

- While some respondents appear to be tracking and measuring a reasonable range of costs, the more common costs measured seem to be the ones that are easier to track – for example, transportation and logistics, customs and warehousing. The harder ones to quantify (and the ones less likely to be measured) are cost of compliance, out-of-stocks and quality costs. There seems to be a misalignment between what respondents feel is important (cost) and the rigour with which they track and measure the elements of that cost. As an example, only about half measure the performance (vendor quality, reliability, compliance) of their vendors or out-of-stocks. For retailers and suppliers out-of-stocks at the retail shelf can be a significant cost in terms of lost store sales and lost margin.

Which of these 'true' or 'hidden' costs associated with your global sourcing strategy does your company track and measure?



Do you consider the tax costs in the review?



- One out of ten did not factor in the tax costs when deciding where to source. Three in ten did not consider tax costs at all when they reviewed their global sourcing programmes.

- Consideration of environmental issues (including carbon footprint) was mentioned by more than half the respondents when considering new sourcing strategies or locations. This is indicative of the increasing focus on the environment as companies consider the future of their sourcing strategies. Compliance with social and environmental standards was tracked and measured by about half of the respondents.

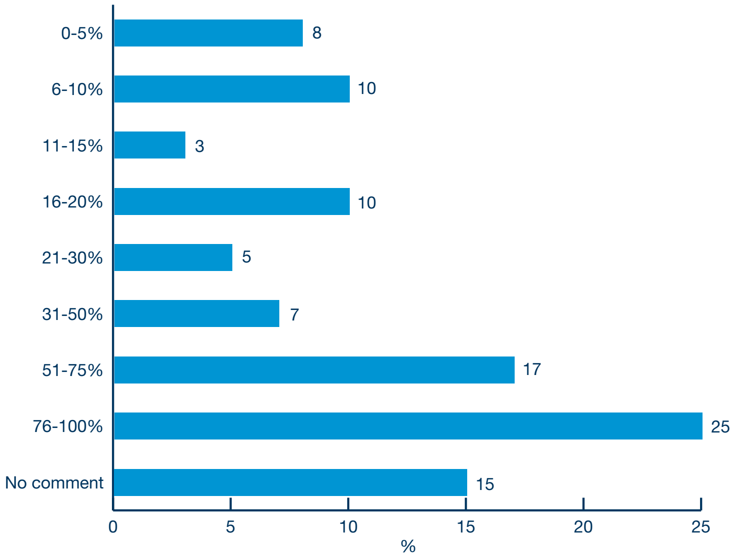
China – the sourcing dragon

The target countries for global sourcing are for the most part the ones we have come to expect, with China the number one destination. Eighty-three per cent of the companies we interviewed mentioned China as their number one sourcing destination. India followed with 58 per cent.

Of our North America-based companies, a resounding 100 per cent targeted China, while Brazil, the United States and Mexico were targeted by 50 per cent. India was a source mentioned by 40 per cent, as were the United Kingdom, Malaysia, Canada and Chile. For Europe-based companies, China was also first, named by 88 per cent. India followed at 72 per cent. Italy was third, (68 per cent), and Bangladesh figured in 44 per cent of sourcing decisions. The concentration on China continued for companies based in the Asia Pacific region. China came out again on top, with 71 per cent, and India was second, with 50 per cent. Our feeling is that China will continue to be the leader in terms of sourcing activities for many years to come; however, concern over rising costs, carbon footprint and other issues may cause companies to step up purchases in other countries over time.

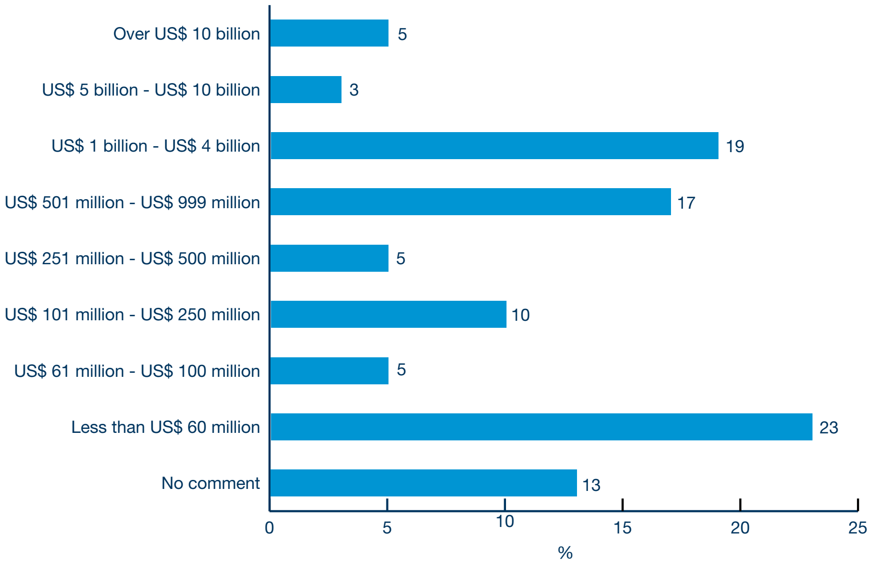
What percentage of all product purchases was sourced globally? Twenty-five per cent of our respondents sourced between 76 and 100 per cent globally.

Per cent of all product purchases sourced globally



Seventeen per cent said they sourced between 51 and 75 per cent outside their own borders. The value in dollars of what was sourced ranged from more than US$10 billion (just five per cent of respondents) to between US$1 billion and US$4 billion (19 per cent) to less than US$60 million (23 per cent).

Value of products sourced globally

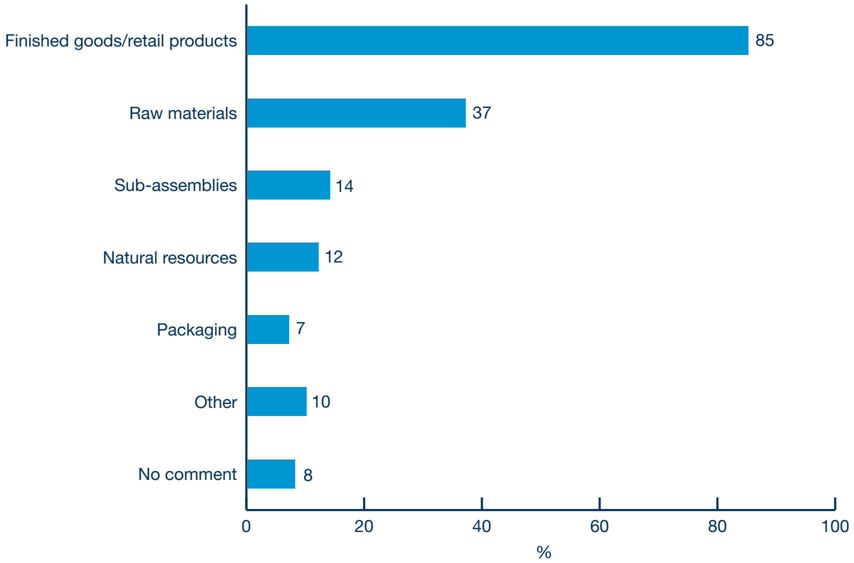


Historic growth rates show that the trend to source globally has gained momentum among participants. Twenty-eight per cent have seen an annual growth rate of between 11 and 20 per cent in the past five years, and 18 per cent have seen a growth rate of more than 20 per cent. When it comes to projecting future growth rates, 20 per cent said they projected global sourcing growth rates of more than 20 per cent and 20 per cent predicted between 11 and 20 per cent.

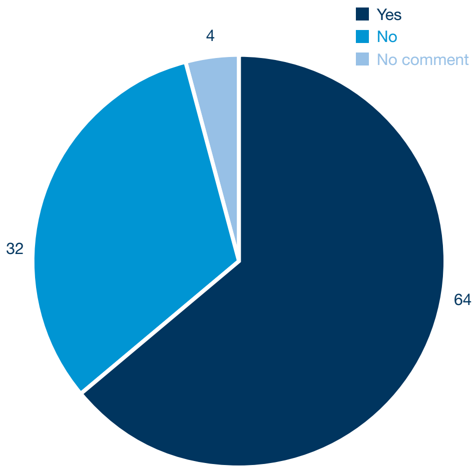
When looking at what exactly is sourced on a global basis, respondents mentioned finished goods or retail products first (85 per cent). Raw materials were mentioned by 37 per cent, sub-assemblies by 14 per cent and natural resources by 12 per cent. Packaging was in single figures at seven per cent.

About half of those we spoke with advised that they were reorganising their operations to adopt a more 'centralised' procurement strategy.

Products sourced globally



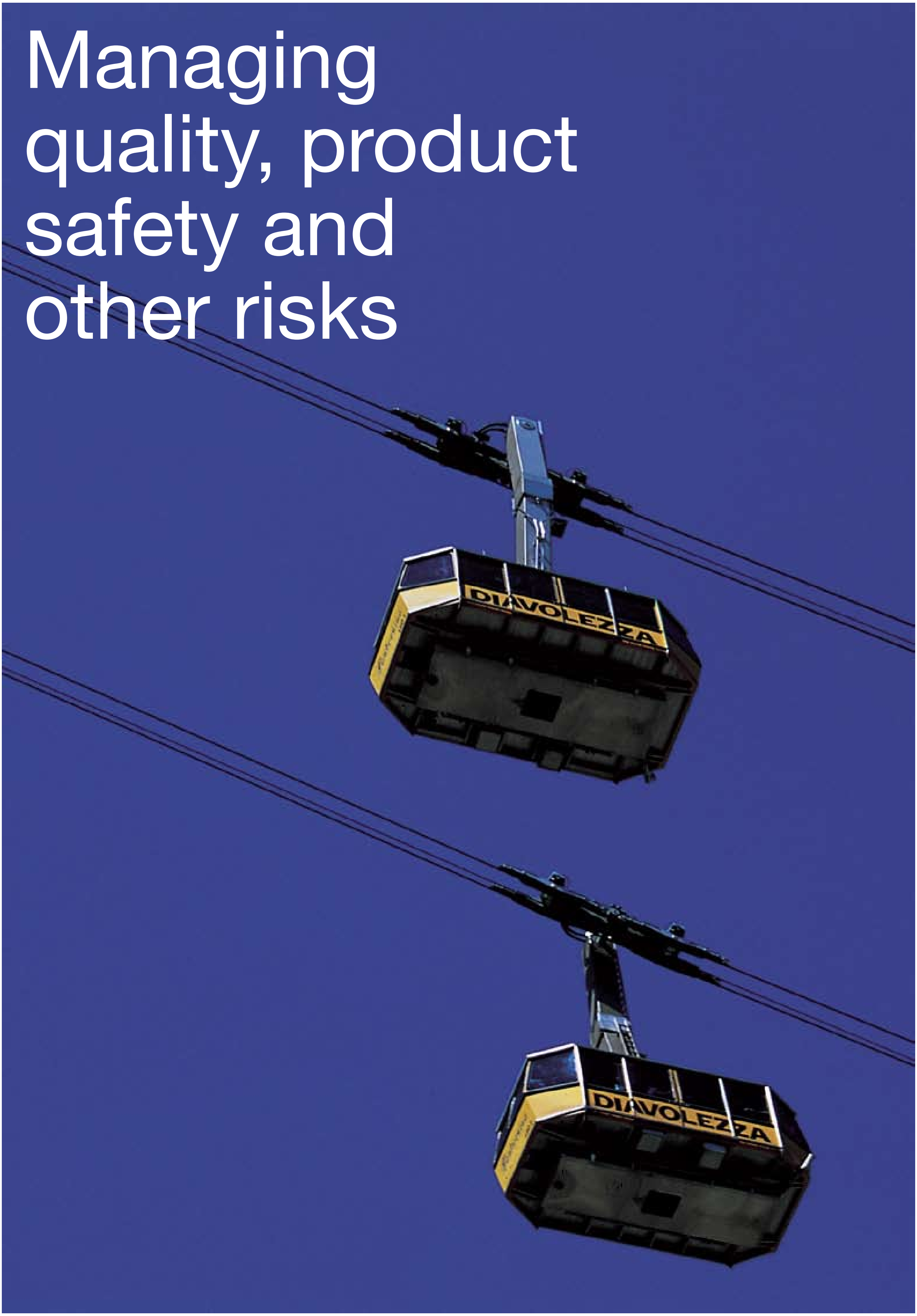
Are you centralising to a specific location?



About two-thirds of those were centralising to a specific location. PricewaterhouseCoopers Advisory Services Director Robert Barrett explains it this way. “Information management and dissemination become more critical in the global sourcing organisation, and this is likely to lead to a more centralised control of the process. Design, production, quality and performance data need to be input and managed in a globally networked manner. Deployed effectively, product lifecycle management systems can reduce lead times for new products, identify design and production problems early and reduce the pain of a recall.”

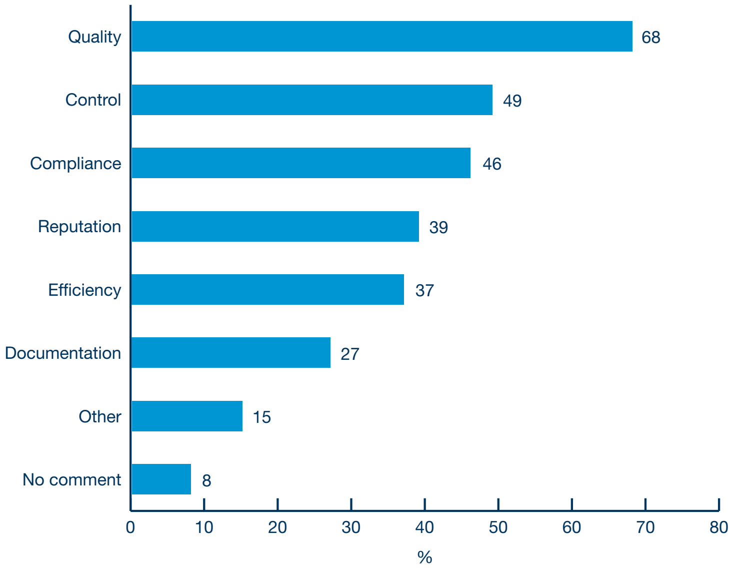
Nearly all respondents (93 per cent) agreed on the importance of the use of third parties, especially for transportation (87 per cent) and freight forwarding (80 per cent), the most commonly cited types of third-party services used. Half said they were currently experiencing added costs for global sourcing technology, and half also said they expected such costs to increase in the future. Nevertheless, three in ten of those who believe it will become more expensive had not considered these additional costs in their global sourcing plans.

Managing quality, product safety and other risks



Product quality was the single greatest risk (68 per cent) cited by our respondents. The other two risks that most concerned them were business control (49 per cent) and compliance (46 per cent). Reputation and efficiency were also concerns, at 39 and 37 per cent respectively.

Which of these do you consider to be the main process risks of global sourcing?



"As our business has become more fashion centric, we have been able to source products from Asia that are not just low cost, but also fit the needs of the customer."

- Steve Gilman, CEO, B&Q Asia

Our respondents' concerns about product quality are well-founded. Recent months have seen recalls of various kinds of products in the United States and heightened the need to manage the risk carefully.

Respondents like B&Q Asia CEO Steve Gilman have a more positive take on the quality issue. "As our business has become more fashion centric, we have been able to source products from Asia that are not just low cost, but also fit the needs of the customer. But perceived quality continues to be a factor – certain globally sourced goods are seen by consumers to be inferior when tagged with 'made in China' when in fact the quality is higher than comparable goods sourced in the United Kingdom," he explained. Ian McDonald, Woolworths Ltd. general manager of global sourcing, concurred by saying that the cost of the product was only one advantage of their global sourcing programme. "We see advantages through quality also," he remarked.

For companies like these and United Biscuits, a leading European snack manufacturer, cost is only part of the value equation. As United Biscuits COO Jeff van der Eems put it, "The biggest issue is value, which is a combination of quality and cost."

"Global sourcing is no longer about finding cheap products quickly. We will continue to shift to a longer term vision focusing on strengthening supplier relationships based on our core values – not just cost."

- Christophe Roussel, international sourcing and logistics director, Tesco PLC

Developing supplier relationships

When it comes to ensuring quality, for some it is clear that the answer is developing suppliers. Christophe Roussel, international sourcing and logistics director at international grocery and general merchandising giant Tesco PLC, noted how important it was for the company to continue to develop strong relationships with suppliers. "Global sourcing is no longer about finding cheap products quickly. We will continue to shift to a longer term vision focusing on strengthening supplier relationships based on our core values – not just cost," he said.

Gregg Forsberg, director, global sourcing international for Best Buy Asia Pacific (Limited) added, "The initial global sourcing thrust was cost savings focused, but that was 1980s-90s – that 'story has been written'. Now the focus is on how we as a retailer – having cut out the middleman – can influence the manufacturing transaction for the benefit of customers. We need to take customer data and insights to build better products." As another of our respondents pointed out, global sourcing was able to shorten his company's lead time, which meant his sourcing process was more flexible. This executive noted that establishing a good relationship with the supplier was particularly important in the retail industry in order to be able to react swiftly to market trends.

"Now the focus is on how we as a retailer – having cut out the middleman – can influence the manufacturing transaction for the benefit of customers. We need to take customer data and insights to build better products."

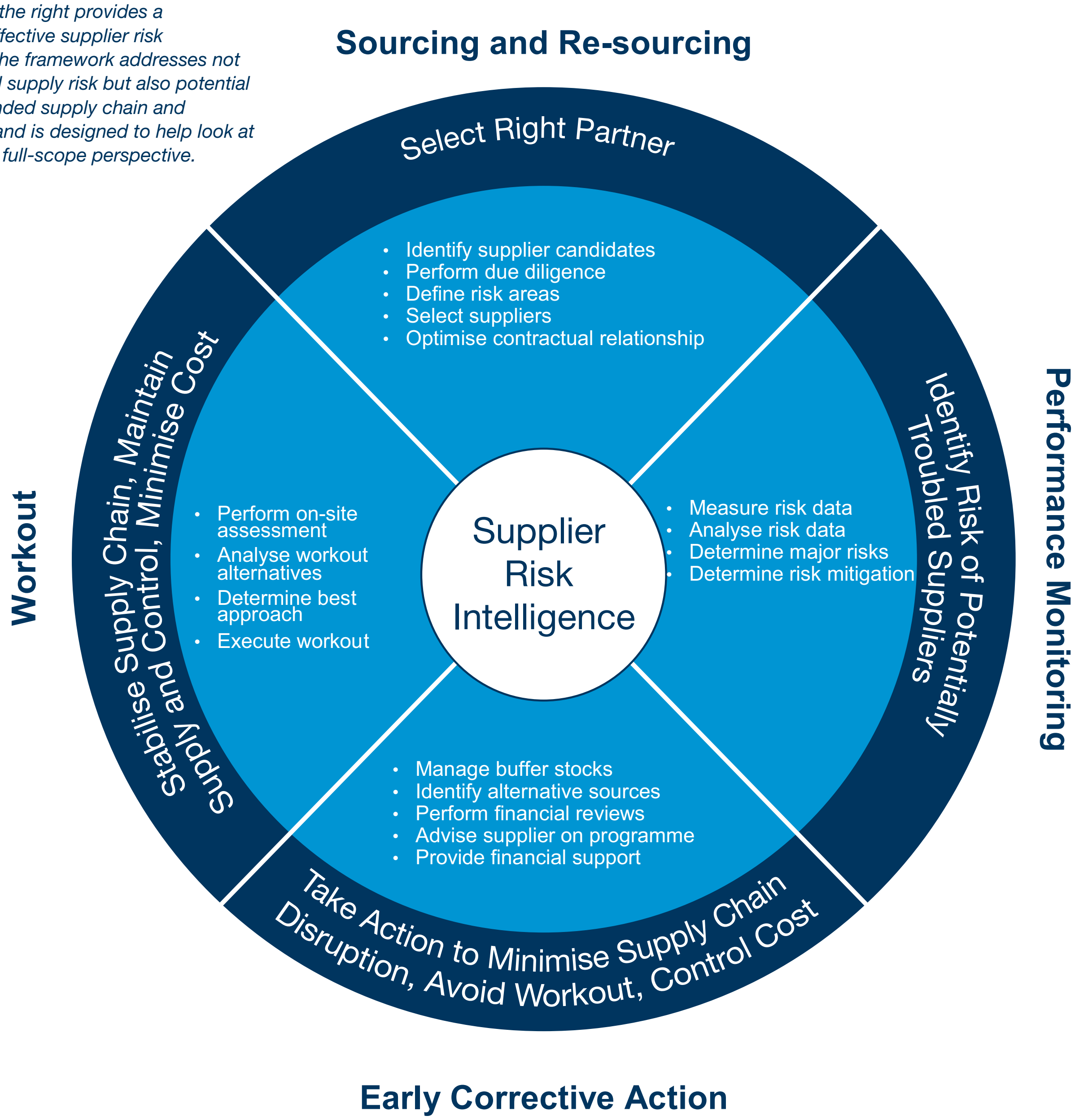
- Gregg Forsberg, director, global sourcing international, Best Buy Asia Pacific (Limited)

Managing supplier and sourcing risk

Many of the recent product quality problem headlines can be traced to failing to understand the extended risk of the supply chain, not addressing risks early enough or not addressing them in a constructive manner.

In fact, there are multiple dimensions to effective supplier risk management. For all companies involved in global sourcing, it is important to understand these dimensions, put together a plan that covers them and put the proper team in place to execute.

The diagram on the right provides a framework for effective supplier risk management. The framework addresses not only the physical supply risk but also potential risks in the extended supply chain and financial risks – and is designed to help look at suppliers from a full-scope perspective.

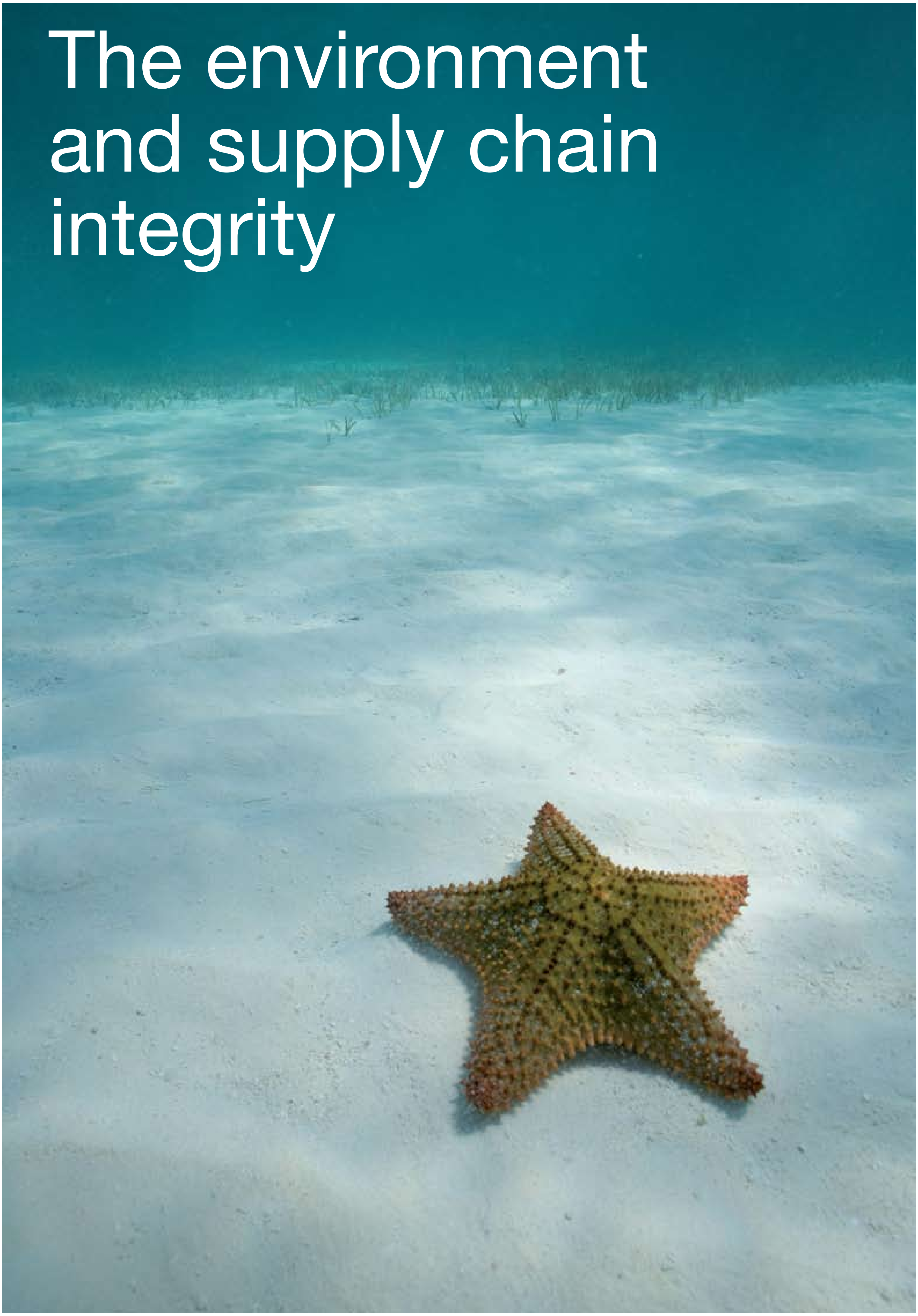


Our experience shows that many companies focus only on the physical flow aspects of managing supply chain risk; however, this is not sufficient. Part of finding the right supplier is ensuring that the organisation has more than just the right equipment and quality. It also makes sense to know whether the supplier has the ability to be a long-term partner with your business. To make that determination it is important to get a complete understanding of the underlying financial resources, management team, extended trading relationships and general management practices.

Once a supplier is selected, a regular and rigourous measurement system is required to identify problems before a shipment arrives and before a major quality problem occurs. The key to this is ongoing and constructive engagement with the supplier.

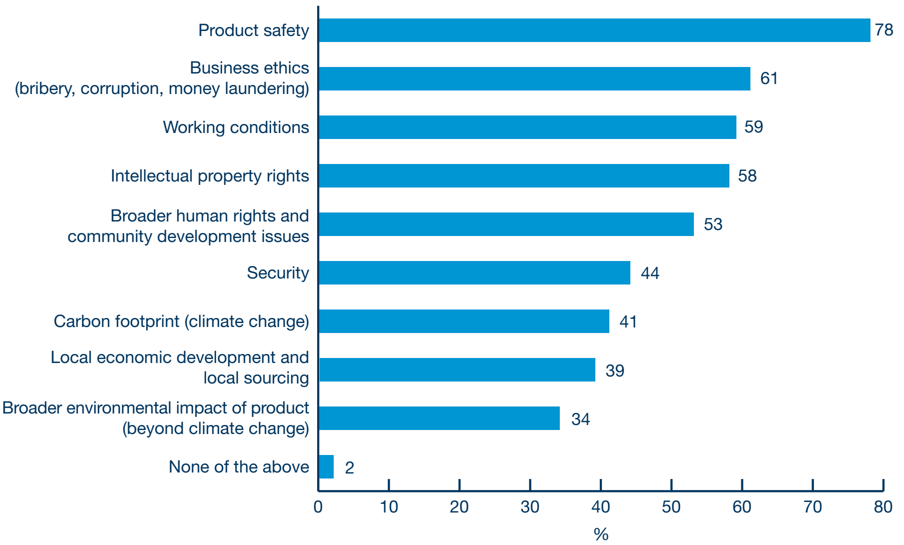
In the event there is a problem, an action plan for addressing both quality and financial issues is critical. This may require a cross-functional team to be deployed to provide assistance, additional training or technical support. It may also mean engaging an alternate supplier. In the event that there is a complete interruption a cross-functional team must be deployed rapidly to identify the problem and develop a course of action that ensures ongoing supply.

The environment and supply chain integrity



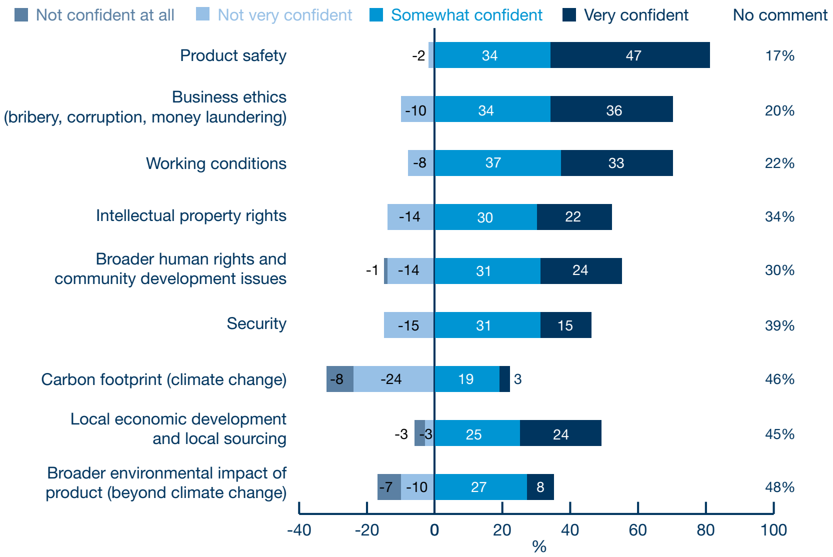
Supply chain integrity is something that the companies we interviewed take seriously. When asked what they considered to be the greatest risks to that integrity, 78 per cent said product safety; 61 per cent said business ethics – including such things as bribery, corruption and money laundering; 59 per cent cited working conditions; 58 per cent cited intellectual property rights; and 53 per cent said they were concerned with broader human rights and community development issues. Concern for security (44 per cent), carbon footprint (41 per cent) and other environmental issues were things that respondents saw as less important.

In relation to supply chain integrity, which of the following issues do you believe represent the most significant risks to your business?



When asked how confident they were about their ability to control supply chain integrity risks, only 47 per cent said they were 'very confident' about their ability to control the risks associated with product safety. A surprising number (36 per cent) were only 'somewhat confident' or 'not very confident'. So although on a relative scale respondents were more confident about controlling product safety risks than some other risks, our feeling is that this falls well short of the mark. With such high percentages lacking confidence, more active steps are indicated to effectively manage product quality risk.

In relation to supply chain integrity, please rank the degree of confidence you have in your company's existing controls for managing these risks.

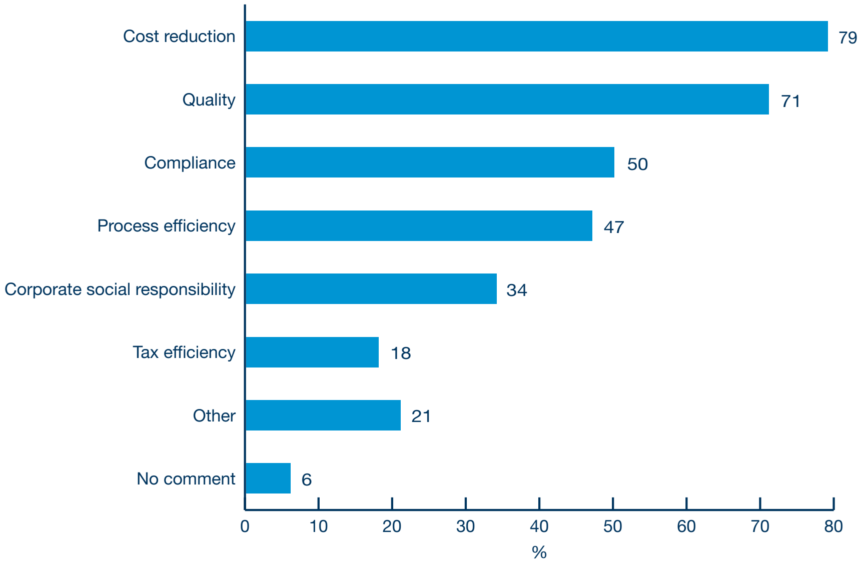


In terms of other risks, 36 per cent were 'very confident' and 34 per cent 'somewhat confident' about controlling risks associated with business ethics. Carbon footprint, security and the broader environmental impact of their products were issues those interviewed were even less confident about controlling.

In fact, almost one-third of our respondents were 'not very confident' or 'not confident at all' about their organisations' ability to properly manage carbon footprint risks. From our results it is clear that companies are still groping with the implications of carbon footprint, as well as other environmental issues, for their sourcing decisions. Far Group Europe's Chandonnay advised, "We consider environmental costs in a positive fashion as they are part of a responsible attitude to managing global resources. These costs are important and need to be taken into account but they do not lead us to question our buying decisions."

Meanwhile, only 34 per cent of respondents were rewarded on issues related to corporate responsibility. In most cases sourcing and procurement rewards are not aligned with overall corporate commitments on corporate social responsibility, nor do they factor in how sustainability issues may impact long-term sourcing and procurement decisions.

Which of these are considered in this (global sourcing) reward?



In most cases sourcing and procurement rewards are not aligned with overall corporate commitments on corporate social responsibility.

We see that leading companies are beginning to broaden buying teams' rewards and incentives by:

- Aligning reward and incentive programmes with corporate goals, strategies and risk exposure
- Articulating trade-offs and providing guidance to buyers to help manage these complexities
- Developing tools that provide buyers with sufficient guidance and information processes to support them; for example, tools to add carbon to cost-to-serve models

Handling carbon footprint and climate change risk

Forty-one per cent of our respondents felt that climate change was one of the most significant risks to their supply chain; however, only 22 per cent were at all confident about their ability to manage the risk.

The issue is becoming more and more important on the retail and consumer agenda. There has been considerable media attention to the subject, and consumers are becoming much more knowledgeable and concerned about potential impacts. Retailers have responded by increasing their commitments on climate change and, to a certain extent, on carbon labelling. A number of high-profile brands have piloted carbon footprint programmes in the past year.

Based on our experience, here are some recommendations for managing these risks:

For retailers

- Make sure that you understand the carbon intensity of your key categories to identify ‘quick wins’ and priorities.
- Encourage your suppliers to bring you new and innovative low carbon products and to reduce the carbon intensity of the products they are already selling you.

For consumer products companies

- Consider high-level mapping and assessment of climate and carbon risks in the supply chain to prioritise products or brands according to carbon and climate risk.
- Look into key products and brands to measure carbon footprint, evaluate climate risks and identify cost-effective opportunities to reduce emissions and manage risks.
- Become more aware of climate impacts through a variety of futures techniques, including forecasts and scenarios.
- Identify regulatory risks in key geographies by reviewing policies and engaging with policy makers.
- Consider climate change impact on security of supply and associated costs of raw materials.

Marks & Spencer is one company which has taken a strong, proactive approach to the potential environmental impacts of its sourcing programme. As Venu Nair, regional head of the South Asia Offices at Marks & Spencer, explained, “We have a robust vendor specifications policy whereby vendors have to meet both ETI (ethical trade initiative), which is an initiative of United Kingdom retailers, and Marks & Spencer’s own global sourcing principles. Our global sourcing principles incorporate environmental impact as part of the criteria.”

Interestingly, a separate PricewaterhouseCoopers consumer research study on sustainability shows that our respondents’ concerns about the environmental aspects of their sourcing programmes are well-founded. Three-quarters of respondents in that survey said they would consider switching where they buy products if they believed a retailer was operating in an unethical manner about environmental issues.

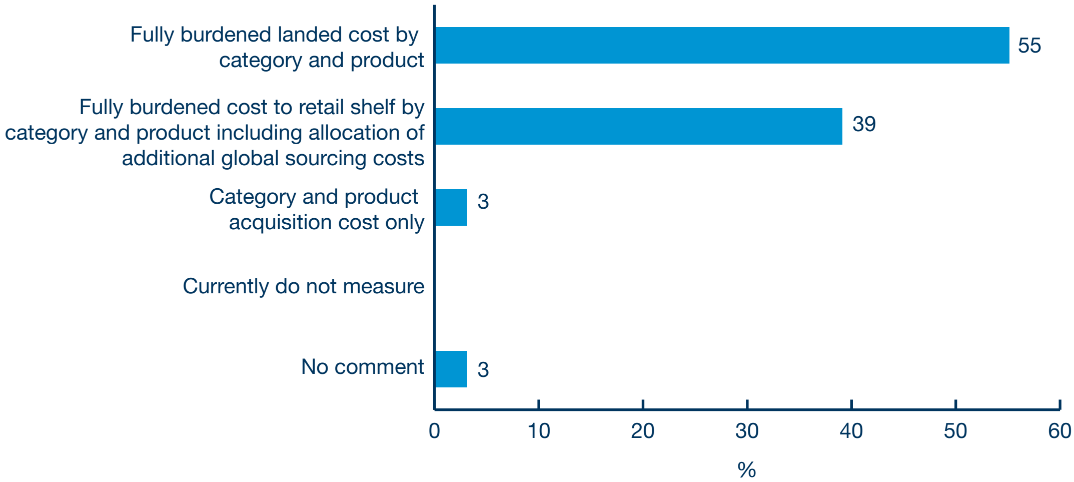
“Our global sourcing principles incorporate environmental impact as part of the criteria.”

- Venu Nair, regional head,
South Asia Offices, Marks & Spencer

Reviews and performance measurement

Considering how crucial performance is to global sourcing, our respondents were mixed in their approaches to reviewing or measuring it. The majority measured global sourcing costs by fully burdened landed cost by category and product (55 per cent). Thirty-nine per cent used fully burdened cost to retail shelf by category and product, including allocating additional global sourcing costs. Just three per cent said they measured only category and product acquisition costs.

Which of these best describes how you measure the true costs of global sourcing?



The frequency of global sourcing reviews varied considerably among our respondents. The good news is, seven out of ten respondents said they had a formal review process in place to watch over global sourcing issues. The flip side is that almost one-third do not. Of those who reviewed their global sourcing procedures 20 per cent did it annually; 22 per cent reviewed semi-annually and 22 per cent quarterly. While companies did note that they had measurement systems in place, we were not able to validate the quality of these measurements.

One of the most insightful results of our survey is that 21 per cent of participating companies did not know what savings to expect from their global sourcing activities. Moreover, 25 per cent of participating companies did not know what their actual savings were. These results show the extent to which many companies are still challenged with putting into place an effective performance programme. Lino Casalino, retail and consumer advisory leader for PricewaterhouseCoopers Canada, noted that he was not surprised by the result. “Global sourcing is a complex set of interrelated activities that cut across many facets of an organisation. In order to properly measure the true impact of global sourcing an organisation must take a balanced approach that considers performance improvement, tax optimisation, business controls, compliance, risk and corporate social responsibility. The global market is in need of this type of integrated approach to global sourcing, as most organisations do not take a cross-functional view of sourcing due to existing organisational boundaries and inefficiencies.”

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Having a balanced scorecard that carefully considers each of these levers is a necessity for successful monitoring and measurement. Our discussions found that most of our participating companies, however, do not take a balanced scorecard approach but instead approach each cost element in isolation. Scratching below the surface, we discovered that the majority of participants tracked and measured those costs associated with global sourcing that are easiest to measure – transportation and logistics (97 per cent), customs and duties (83 per cent), warehousing costs (83 per cent) and currency risks (75 per cent). Only about half of the companies measured more difficult costs, such as those associated with vendor performance and compliance monitoring (53 per cent), compliance with social and environmental standards (53 per cent), out-of-stocks (53 per cent) and information systems/technology (39 per cent).

Consistent with best practices, the vast majority of respondents (78 per cent) regularly compare global sourcing against other potential off-shore alternatives, as well as local and on-shore alternatives. The ‘glass half empty’ scenario, however, suggests that one in five companies currently engaged in global sourcing do not regularly challenge their own paradigm and consider the costs and lead time savings from local, on-shore alternatives or potentially the cost savings to be generated from another off-shore sourcing country.

Measuring and tracking supplier performance

Measuring the performance of suppliers is an important part of successful global sourcing and is best considered early in the sourcing process. Our experience shows that if considered early enough, measuring supplier performance can minimise risk and act as a valuable guide for ongoing supplier development. Like any other kind of framework, one for measuring supplier performance needs to include a balanced set of dimensions.

Typical categories for measurement include:

- Financial and commercial measures that track performance to contractual and other benchmarks. Typically these are price focused, but our experience indicates that looking at extended financial activities will highlight potential interruptions before they occur.

- Quality measures that track performance against specifications and practices and ensure that suppliers track the quality and specifications of their own extended suppliers.

- Delivery measures that track the physical flow of products in terms of timeliness and accuracy.

- Support measures (typically qualitative) that measure and track the openness, information sharing and extended relationship dimensions of suppliers.

Typical Supplier Measurement Framework

Category	Measurements	Measurement Objectives
Financial/ commercial	Price	To compare the recent price with market and other benchmarks
	Terms and conditions	To compare the performance against any contractual terms and conditions
	Extended trading terms	To ensure that the supplier is sufficiently liquid and is paying its employees and suppliers on time
Quality	Reject rate	To measure the percentage of defective and rejected incoming material
	Quality events	To measure the frequency of quality events or check in relation to an agreed or industry baseline
	Extended supplier quality	To measure the adherence to quality validation for materials and components of second and third-tier suppliers
	Supplier corrective action	To measure the response time and effectiveness on quality corrective action requests
	Defect rate	To measure downstream quality defects on accepted material
	Quality support	To measure how responsive the supplier is to support one-time and ongoing quality initiatives
Delivery	Delivery accuracy	To measure the completeness of an order in terms of items and item quantities and sequence
	On time delivery	To measure the timeliness of deliveries against the promised date
Support	Information sharing	To measure willingness to share strategic information and business decisions in exchange for same
	Support for recall and/or warrantee events	To measure the completeness and timeliness of data requests and support in the event that a warrantee or recall event occurs
	Support for product differentiation	To measure whether the supplier has the intention and ability to support and maintain long-term product development and other relationship matters
	Industry leadership	To measure whether the supplier’s technology strategy direction is supported by investment and is consistent

Other measures can include adherence to environmental and other regulations, but these tend to be more difficult to measure and track in a cost-effective way. These are typically monitored on an audit basis.

The availability and transparency of data and information are typical concerns. These are especially valid in emerging markets where reporting standards continue to evolve. However, if these measurements are used constructively – more as a 'carrot than a stick' – suppliers tend to be more open about their own issues and problems. Rick Hughes, vice president of global purchases, Procter & Gamble, noted the complexity of monitoring performance by saying, "No matter the sophistication of your systems, there is no substitute for physical visits to suppliers to validate that their operation is up to your standards and their claims."

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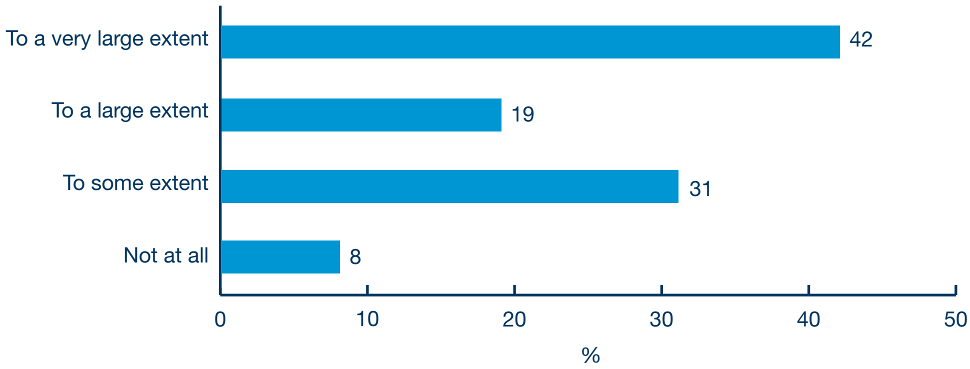
- Rick Hughes, vice president of global purchases, Procter & Gamble

It is important to have this framework decided in advance of any long-term supply agreements. Suppliers need and deserve to have an understanding up front about how they will be measured. Indeed, the appropriate measurement framework is an excellent tool to communicate corporate values and the desire to develop a relationship. However, if used in a punitive manner, it can easily lead to supply interruptions, tension and a permanently damaged relationship.

Tax issues

Only 46 per cent of companies consider tax optimisation for their sourcing strategy. Thirty-nine per cent do not factor tax costs into landed costs or only do so to a limited extent.

To what extent would you say that you factor tax costs into your buying decisions, i.e. landed costs?



Forty-eight per cent of companies were somewhat or not confident that they were dealing with tax compliance correctly – or didn't know.

Nearly one-third of the companies do not consider tax costs as part of their review of their global sourcing arrangements, but 61 per cent do measure their tax exposures to customs duties, corporate and environmental taxes. Only 18 per cent include tax efficiency as a metric in assessing employee reward. Thirty-six per cent of respondents use third parties to advise on customs duties and corporate taxes. Forty-eight per cent of companies were somewhat or not confident that they were dealing with tax compliance correctly – or didn't know.

It would appear that in the competitive arena of global sourcing, where cost benefits are already being achieved, there is a significant opportunity for companies to get ahead through supply chain tax optimisation. From our survey it appears that indirect taxes and the local tax transactional footprint are being considered by the majority of companies, rather than the overall strategic tax position. How many companies are looking at where the cost savings from sourcing will ultimately sit and whether they could implement planning to ensure the minimum amount of tax is payable?

Clare Bolton, global retail and consumer tax leader at PricewaterhouseCoopers, advised that tax authorities around the world are looking more closely at activities and taxes paid by companies with global sourcing models. She said, “It is important that global sourcing tax strategies are well thought through and implemented. Activities must be closely aligned with profits, tie in with robust transfer pricing policies and minimise customs duties and other corporate tax exposures. Tax compliance procedures need to be carefully carried out and legislative changes closely monitored. Furthermore, in my experience, those companies in which performance metrics are linked to tax efficiency are the ones most likely to stay ahead of the game.”

Indirect taxes and the local tax transactional footprint are being considered by the majority of companies, rather than the overall strategic tax position.

Here are some tax-related questions to consider in global sourcing planning.

- What are the savings anticipated through the centralisation of global sourcing?
- Where will the savings sit in your structure if you do nothing to tax optimise it?
- Do the savings arise primarily as a result of bulk discount arrangements or is the procurement function adding additional value?
- Have you considered leveraging the procurement company into an integrated supply chain management company?
- How can your tax and legal structure accommodate multiple procurement centres across different regions?
- How might direct tax savings affect customs duty costs, and vice versa?

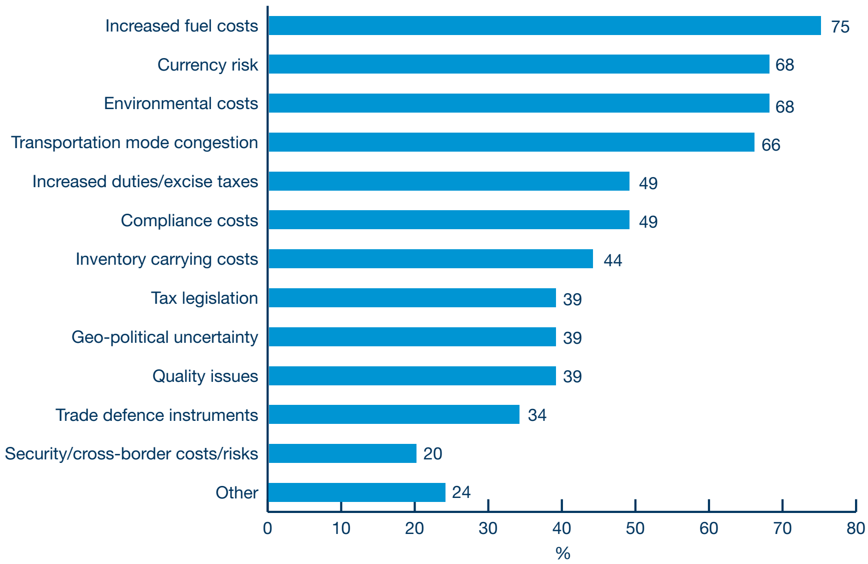
Tax opportunities related to global sourcing vary by country and by sector. However, our experience indicates that tax-efficient solutions can be tailored to the circumstances of most companies.

Conclusion: Looking to the future

With close to half our respondents having seen global sourcing activities grow by 11 per cent or more over the last five years – and with 40 per cent predicting growth rates of more than ten per cent in the coming five years – the outlook is dynamic indeed.

As they look to the future our respondents saw some potential barriers to achieving incremental cost savings. These included increased fuel costs (75 per cent), currency risks (68 per cent), environmental costs (68 per cent) and transportation mode congestion (66 per cent). A wide range of other barriers was mentioned, including increased duties, compliance costs, inventory carrying costs, tax legislation and geo-political uncertainty. Continuing to enhance strategy was seen as the best way to improve the performance of a global sourcing programme (63 per cent). Measuring benefits and costs was also seen as crucial (49 per cent).

Which, if any, of these issues do you anticipate will be major barriers to achieving incremental cost savings from your global sourcing programme in the next five years?



It is interesting to note that while fuel cost and the environment were ranked at the top of the list of possible barriers, quality moved down (39 per cent). Why, when asked about the main barriers to achieving incremental cost savings, would quality not be top of mind? The only explanation our team felt was plausible is that organisations may still view cost and quality as mutually exclusive variables. When our respondents discuss global sourcing and cost savings they may not typically consider quality to lead to cost savings. Also, during the time period in which this study took place there was a heightened awareness of global oil prices, so it is not surprising this would be high on our respondents' lists.

The environment also emerged as a key consideration when the survey group looked toward the future of their global sourcing programmes. It is clear that companies do not fully comprehend the potential impact that carbon footprint and environmental costs might have on the future of global sourcing. Cost, quality and the environment will all play an increasingly important role as companies seek to achieve new heights of performance and competitive advantage from their global sourcing programmes.

In order to be successful, organisations must treat global sourcing as they would a very significant strategic project – with its own investment, risks, costs and benefits. Companies must become more sophisticated and apply more rigour in their methods to understand both the costs, risks and savings associated with their decisions. Companies must also begin to look for new ways to differentiate themselves through their global sourcing activities – either through cost, quality, brand or environmental approaches.

What seems clear from our results is that – while they are moving in that direction – the majority of our respondents are not yet taking advantage of all the potential benefits of their global sourcing operations. According to PricewaterhouseCoopers Global Retail and Consumer Leader Carrie Yu, "Clearly, our results show that global sourcing is a journey. While some companies have a robust process for reviewing and monitoring the benefits and savings arising from their global sourcing efforts, other companies are either not aware of the potential benefits or do not have the systems in place to track them."

"There needs to be a mindset shift. Global business needs to think globally and develop a truly global approach across different countries for the best overall result and to overcome regional or local interests."

- Ngawang Lobsang, global procurement director, Cadbury Schweppes plc

“Huge opportunity, manage the risk. Always understand all the trade-offs involved.”

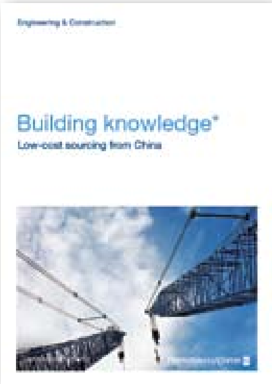
- Walter Ettlin, vice president finance, global sourcing, Levi Strauss & Co.

The good news is that companies are moving on and recognising what can be achieved by developing a truly global approach and by creating strong relationships with suppliers. Cadbury Schweppes plc Global Procurement Director Ngawang Lobsang echoed these sentiments. “There needs to be a mindset shift. Global business needs to think globally and develop a truly global approach across different countries for the best overall result and to overcome regional or local interests.”

Looking forward we believe that the most successful companies will be those that can foresee and adapt to rapid changes in the marketplace. This will include an ability to develop global sourcing models that enable ‘what if’ scenarios, in which variables such as currencies, fuel prices and quality costs are weighed against the cost savings associated with sourcing from alternate locations.

Walter Ettlin, vice president finance, global sourcing for Levi Strauss & Co. summed it up well: “Huge opportunity, manage the risk. Always understand all the trade-offs involved.”

Further reading on sourcing, supply chain and outsourcing topics, such as the reports below, can be accessed at www.pwc.com/r&c.

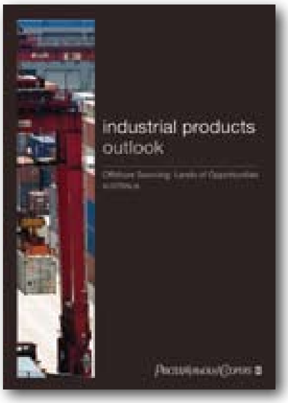


Building knowledge: Low-cost sourcing from China (engineering and construction industries)

Collaborate and Innovate: a new world of sourcing

Emerging Markets Perspectives – CEO Insights Report: Convergence & Differentiation – What is success in a connected world?

How retail and consumer companies can use strategic sourcing to achieve business objectives



Industrial products outlook – Offshore Sourcing: Lands of Opportunities

Outsourcing comes of age: The rise of collaborative partnering

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Our Global Industry Programme demonstrates our industry strengths and drives value for our clients. The programme's foundation is a deep understanding of business and industry issues, connected with meaningful solutions. Companies leverage our extensive industry resources and knowledge to compete more effectively in specific marketplaces. Our global retail and consumer industry group has designated professionals and territory sector leaders in more than 50 countries around the world, serving all types and sizes of retail and consumer goods companies. A network of retail and consumer-focused subject matter experts assists with transactions, global sourcing, international accounting regulations, transfer pricing, customs, tax and other issues.

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