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Global Sourcing: Illusive Profits, Expensive Mistakes

The pitfalls of overseas sourcing: recognizing and managing the real-time cost impacts and financial liabilities of complex global supply chains.

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By

Global sourcing has become the strategy du jour as enterprises seek to reduce cost of acquiring, building and selling products in a continual effort to compete more successfully for customers. Yet extending supply lines overseas brings with it new commercial and operational challenges that are far more complex than before, and expose the enterprise to an entirely new universe of investments, costs, partners, liabilities, resource acquisition and management needs.

The result -- sourcing initiatives that do not deliver the projected cost savings and/or profits because the risks and costs of longer, more complex cross-border supply chains were not properly understood, tracked and managed.

The Rush To Outsource, Hidden Pitfalls

As companies come under increasing pressure to compete on price, the rush to "outsource" and embrace cheap overseas labor and low-cost manufacturing in developing countries has resembled a modern-day version of the historic California gold rush. The only difference is that the modes of transportation are ships and planes instead of horses and covered wagons.

Five years into the new millennium, tens of thousands of companies have moved sourcing and manufacturing overseas. Where in 2000 it was not uncommon for a U.S.-based company to have 10% or less of its products provided by suppliers in another country, today those same companies are going overseas for 50%, 70%, even more than 90% of their products.

And while the purchasing departments in all those organizations will point with pride to all the money they have saved their companies, a walk down the hall to the logistics and supply chain group reveals a far different story. Running a logistics operation from Austin, Texas to Buffalo, New York has far fewer moving parts, fewer and less complex cost components, and lower impact on financial cash flow than a cross-border supply chain from Osaka, Japan to Columbus, Ohio. The risks and challenges are an order of greater magnitude.

2007 at the Hyatt Regency Indianapolis, Indiana. The session *The Hidden Costs of Global Sourcing* will be held on Wednesday, April 25, 2007 at 9:10 a.m. To register for the conference and view the entire list of speakers visit http://www.iwbestplants.com/.

Independent Functions, Disconnected Systems

Logistics and procurement departments tend to be "siloed" functions that because of their focus, how they are measured, and how they are compensated, often end up actually working at cross-purposes, with one gaining or losing at the expense of the other. The purchasing folks are measured by unit price. The logistics team is measured by transportation spend or total logistics cost as a percent of revenue.

Add to this mix yet another separate management system and employee group -- accounts payable -- where the company's bills are received, checked, assigned to cost centers and paid. The resulting picture is one where many operational processes are running concurrently but have little or no visibility into each other. Yet each has an impact and a role in how an organization understands, manages and controls its global costs, cash flows and profitability.

Lacking a common, integrated cost tracking, measurement and analysis system that "overlays" and connects these silos, they are like ships passing in the night, mostly unaware of either's presence. Without an overarching system that provides real-time intelligence into the global "financial supply chain" -- and allows accurate and timely visibility to both global sourcing and logistics costs as they are incurred -- disaster is bound to result. And it's a disaster that typically does not show up on the company's bottom line until weeks or months later. Several industry reports provide examples of the impact:

- A European retailer looking at the landed cost of health and beauty care products on its shelves uncovered an astounding 3,500 of 5,200 products that had no contribution or a negative impact on net profitability. They were in fact dead weight or subsidized by the remaining profitable offerings.
- A diversified Fortune 250 retailer embarks on an initiative to increase from 5% to 30% a number of material, component and service activities sourced in four low-cost countries, with a projected savings in cost of goods sold (COGS) of $200 million. With longer supply lines the initiative also had to account for logistics costs that could potentially rise to as much as 40% of COGS, as well as the challenge of how to assign these costs back to individual items for profitability analysis. The projected COGS savings is significantly adjusted downward.
- A manufacturing enterprise successfully expands its global supplier base, saving $20 million, only to find that logistics costs had increased by $38 million due to increased trucking expenses.

Advantages Of Dynamic Global Cost Control Systems

Integrated global cost control systems present significant advantages and can be the source of qualitative as well as quantitative differentiation for a global enterprise. Major opportunity areas include:

Improve target costing -- Accurately understanding target costs -- the expected full cost to purchase goods from an overseas supplier and get them to market -- is the key to profits. Dynamically tracking actual cost against previously set targets quickly uncovers targets that are unrealistic or inaccurate. Early visibility into the delta between these two allows shippers to quickly adjust targets and modify plans for downstream product pricing and marketing campaigns. By reducing from months to weeks or even days the discovery of unrealistic targets, companies can save millions in lost margins.

Dynamically report and manage costs -- By implementing a global platform that automates and centrally manages global logistics data collection and consolidation, substantial reductions in cost reporting delays are made possible. Traditional reporting solutions suffer from latency problems and are good only for post-audit or "after the fact" analysis. Issues that may be uncovered relate to logistics activity that's long since been completed; retroactive resolution is not possible. With dynamic cost reporting, lead-time for actuals can be cut from days or weeks to hours. Supply chain issues are exposed early. Enterprises can takes steps to respond quickly and correct them before excessive costs are incurred.

Track the liability pipeline -- As globally sourced goods are manufactured and then start their journey to market, the enterprise incurs liabilities for payment of goods and services. With actual global cost tracking, financial managers can literally "watch the meter build" as sourcing and supply chain milestone activities are executed, and the costs are incurred. This intelligence can be used better assess obligations as well as current and future cash flow needs. The integrated global cost control system also supports key financial management processes that underpin accurate total cost management. These include:

- **Cost allocation** -- Costs can be automatically allocated by the system in the proper proportion to the right shipment, order, product line item or SKU. No "orphan" costs are left out and the resulting global landed cost calculation is accurate.
- **Cost audit** -- Costs can be automatically audited in the system. For example freight costs can be matched against transportation contracts, duties against item classifications, first cost against commercial invoice or original purchase order.
- **Cost timing** -- The time in which a certain liability (cost) was incurred can be audited or matched by the system against a corresponding event in the physical supply chain. For example, transfer of title to goods (and resulting payment) can be associated with or triggered by related events in the "physical" supply chain, such as Forwarder Cargo Receipt, Vessel On-Board or Vessel Arrival.

Conclusion

Experience has taught us that outsourcing and strategic relocation of manufacturing and supply bases to lower cost countries can help enterprises reduce cost of goods sold. However, history also proves that the savings from those sourcing initiatives can quickly evaporate without effective technology platforms and systems capable of managing longer and more complex supply lines, and the larger, more extended financial commitment required to operate them. It's the holy grail of global supply chain management.

Tangible benefits in global sourcing and cross-border supply chain performance, as well as measurable improvements in bottom-line profitability can be obtained by investing in and deploying today's advanced, Internet-based global cost control systems. These herald the next generation of landed cost management, introducing new measures of value and benefit through connected networks that synch up the physical and financial supply chain, and deliver new-found visibility and control over a broad swath of global sourcing, trade and logistics operations.

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