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UPS AND DOWNS

Asian sourcing has transformed most manufacturers' supply chains during the last decade, either directly or indirectly. On average, companies that source from Asia net 13 percent savings on their largest-spend category (and much more on smaller volume and lower-value purchases), making sourcing a strategic imperative. No wonder these companies have projected a 70 percent increase in low-cost country sourcing by 2011. While China is the sourcing location chosen by a margin of more than two to one, other countries, such as those in the Middle East, Eastern Europe, and Latin America, are becoming equally attractive.

While the opportunity seems clear, formulating the right long-term manufacturing and sourcing strategy is increasingly complex. Success requires a good integration of context, education, information, and wisdom from experience. Supply chain planners will need a new set of international business and economic skills to assess the potential impact of five variables that could affect China's advantage as a low-cost country source moving forward.

Key economic variables underpinning the Asian sourcing boom are increasingly volatile. These factors include:

Chinese labor cost inflation. China's labor cost has more than doubled since 2002 (it has increased by 150 percent, actually). Rising wages have started to change how companies operate in China. U.S. corporations and their suppliers are starting to rethink where to locate facilities, whether deeper into the interior (where salaries and land values are less), or even farther afield, to lower-cost countries such as Vietnam or Indonesia. Already, higher labor costs are beginning to price some manufacturers out of more developed Chinese cities, such as Shanghai and Suzhou.

Devaluation of the U.S. dollar. Exchange rate changes are tempering the benefits of off-shoring to American companies and making U.S. exports to Europe more competitive. Since 2000, the dollar has lost 48 percent of its value against the Euro and 21 percent against the Chinese Yuan. This has helped U.S. manufacturers' export competitiveness and dampened the thirst for off-shoring. Conversely, Europe's export

competitiveness has been challenged by a rising Euro. If the U.S. dollar continues to depreciate against the Chinese Yuan, this could begin to tilt the balance in favor of sourcing from domestic U.S. companies.

Increasing shipping costs. Higher fuel costs are driving freight rates higher and profitability lower. The cost of diesel fuel has more than doubled (160 percent increase) since 2000, and the cost of steel has more than tripled (230 percent increase) since 2003, both of which have had an impact on ocean shipping rates. If current trends continue, the cost of shipping could begin to make Chinese goods less attractive to American and Western importers.

Dual sourcing. More companies are dual-sourcing to assure continuity of supply. The events of September 11, 2001, caused many companies to design resilient supply chains that would survive a terrorist attack. This led to the use of deliberate redundancy in the form of dual sourcing—using suppliers on both sides of the Pacific instead of depending on an overseas supply line. The dockworkers' strike in 2002 reinforced the use of multiple ports to safeguard supply in the face of possible port shutdowns, and the memory of that strike was recently reawakened with the threat of an International Longshore and Warehouse Union strike. Dual sourcing dampens the economic effect of off-shoring.

Environmental regulations. Asian environmental and social regulations are increasing off-shore costs. If China and other nations take air pollution more seriously, the "free ride" that manufacturers are currently getting may end up costing money. That money would further reduce the differential between Chinese and Western delivered costs.

Some company leaders are bringing back manufacturing that had previously been off-shored, or they are trying to decide what combination of products and services to offer to win in the new and more competitive game.

The most important success factor for global sourcing will ultimately be the ability to integrate knowledge into strategic supply chain decisions that involve investment and risk. The skill set needed to do that is different today than it was a decade ago. Supply chain professionals who want to achieve supply chain excellence should also consider accepting an international post to gain an appreciation for what it takes to be successful in a different culture. Managers should find a way to make their work team cross-cultural if it is not already to leverage the value of cross-cultural differences.

All can gain from increasing internationalization, but like the stock market, there are ups and downs. Operations professionals make many of the decisions that turn the wheels of commerce and world trade, and they determine the direction of that trade. No wonder the profession is getting so much more attention these days.

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Additional Resources

Jacoby is presenting "Global Logistics: The Next Generation" during the 2008 APICS International Conference & Expo, September 14-16, in Kansas City, Missouri. For more information and to register, visit www.apicsconference.org.