



Aberdeen *Group*

Low-Cost Country Sourcing Success Strategies

*Maximizing and Sustaining the
Next Big Supply Savings Opportunity*

June 2005

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Executive Summary

Issue at Hand

There have been several pivotal developments that placed procurement on the front lines of corporate strategy. In the 1970s, it was the energy crisis. In the 1980s, it was competitive pressures from Japan. In the 1990s, reverse auctions and outsourcing made effective procurement a priority. Today, low-cost-country sourcing (LCCS) is again putting procurement at the forefront of corporate strategy.

Continued pressure to reduce costs, globalization, outsourcing, and liberalization of trade restrictions have conspired to produce a surge of interest in sourcing from suppliers located in countries where labor, material, manufacturing, and operating costs are significantly lower than in more developed economies. The shift to low-cost country sources is impacting entire supply chains in all regions, with manufacturers like General Motors, Toyota, and others pushing suppliers to match prices from low-cost nations such as China and Malaysia.

Such factors have made LCCS a priority for survival in many industries. Not surprisingly, recent Aberdeen Group research showed that chief procurement officers view LCCS as a top priority for the next three years.¹ Overall, enterprises plan to double their spending with offshore suppliers by 2008.

The prime motivation for LCCS is clear: cost savings. Total costs for goods purchased from low-cost countries are 10% to 35% lower, on average, than in more mature economies, such as the United States and the nations of Western Europe. Procurement executives also report that LCCS is vital to expanding into new markets and improving service and delivery performance to global customers.

However, LCCS opportunities come with new supply challenges and risks – from complex logistics, trade regulations, and tariffs, to cultural and infrastructure issues, to immature suppliers. Enterprises embarking on LCCS initiatives must constantly balance trade-offs between cost savings opportunities and supply performance and risk.

To better advise enterprises on how to capitalize on the LCCS opportunity, Aberdeen Group examined the LCCS strategies and experiences of more than 170 enterprises. We augmented this research with dozens of in-depth interviews with LCCS pioneers. (This research complements previous Aberdeen studies into global sourcing and trade.²)

¹ *The CPO's Agenda* (March 2005)

² *The Global Trade Management Benchmark* (March 2005); *The China Trade Management Benchmark* (December 2004); *The Global Sourcing Benchmark* (September 2003)



Key Business Value Findings

The findings from our study were alarming. Despite heightened interest, few enterprises are fully prepared to optimize results and mitigate risks of LCCS. Specific findings include:

- ***LCCS initiatives often lack strategy.*** Many procurement executives report that their companies' LCCS initiatives have largely been reactionary to customers' or competitors' moves.
- ***Most companies are ill-prepared to plan and execute LCCS.*** Enterprises – especially small and mid-market companies - readily admit they don't have the internal knowledge to thoroughly assess foreign supply markets or supplier capabilities.
- ***LCCS is not a quick fix.*** Everything takes longer when a company deals with an LCCS program, from supplier assessment to sourcing to supplier development and supply lead times, to realization of cost savings.
- ***Logistics operations and costs are chief challenges.*** Low-cost countries often have undeveloped infrastructures that can result in shipping delays and damaged or mishandled goods. Increased demand in many low-cost regions – such as China – is also straining shipping capacity.
- ***Most goods and services procured via LCCS are exported*** and consumed outside the country where they're procured.
- ***Technology has had little impact on LCCS initiatives so far.*** Most low-cost regions are immature and inconsistent supply markets, with limited physical and technological infrastructure.
- ***LCCS is a moving target.*** Low-cost countries don't remain low cost for extended periods of time. An LCCS strategy should include plans for exiting low-cost countries.
- ***LCCS benefits correlate with level of commitment.*** Enterprises that make a major commitment to LCCS (defined by Aberdeen as procuring more than 20% of total company spend via LCCS) enjoy significantly higher cost savings of procured goods, inventory savings, and logistic cost reduction than enterprises that source only a fraction of their spending (less than 20%) from low-cost country suppliers.

Implications & Analysis

LCCS simultaneously offers significant opportunities and formidable challenges for supply management organizations. Procurement must address difficult questions:

- What spend categories (materials, products, components, services) should be purchased from low-cost countries?
- How and when will LCCS pay back the cost of switching suppliers and making the needed investment?
- From which low-cost countries should goods and services be purchased?



- What suppliers in any given country possess the capacity, capability, and financial stability to meet supply requirements?
- Should funds and other resources be allocated to develop suppliers' capabilities in the low-cost country or region?
- Will goods sourced from low-cost countries be consumed in that country, exported to the U.S. or other countries, or a combination of both?
- Should a company develop the internal knowledge, domain expertise, and other skills internally to support the LCCS initiative?
- Should a company establish an international purchasing office (IPO) in the country or region where it will purchase low-cost goods? What level of staffing should the IPO have?
- Is intellectual property (IP) sufficiently protected?
- How will the extended supply chain be managed?
- How will visibility through the extended chain be achieved, and how will new, low-cost suppliers be integrated into the overall supply chain to synchronize supply with changing demand?

Upshot: Despite potential LCCS benefits, without proper planning and the use of superior sourcing skills, enterprises that move too quickly run the risk of facing high up-front costs, supply disruption, and little, if any, financial return. On the other hand, enterprises that ignore LCCS will be at a competitive disadvantage.

To facilitate the decision-making process of whether a specific spend category is a strong candidate for LCCS requires a detailed examination of attributes of both the goods to be sourced and the specific low-cost supply markets. Aberdeen has developed a framework for the LCCS decision-making process, which is included in Chapter Three.

This research report examines opportunities and risks of LCCS in detail, and provides strategies for navigating the LCCS waters for sustained results. Also included are case studies that illustrate proven strategies and convey the experiences of LCCS pioneers.



Table of Contents

Executive Summary	i
Issue at Hand	i
Key Business Value Findings.....	ii
Implications & Analysis	ii
<i>Chapter One: Issue at Hand</i>	1
The Compelling Case for LCCS.....	2
Pressures, Actions, Capabilities, Enablers (PACE).....	3
<i>Chapter Two: Key Business Value Findings</i>	7
LCCS Trends and Implications	7
Presence in Foreign Markets	12
Mitigating LCCS Risks	19
<i>Chapter Three: Implications & Analysis</i>	22
Process and Organization	25
The LCCS Decision-Making Process.....	28
<i>Chapter Four: Recommendations for Action</i>	29
Laggard: Steps to Success	29
Industry Norm: Steps to Success	29
Best in Class: Next Steps	30
Featured Sponsors.....	31
Sponsor Directory	33
Author Profile	34
<i>Appendix A: Research Methodology</i>	35
<i>Appendix B: Related Aberdeen Research & Tools</i>	37
About AberdeenGroup	38



Figures

Figure 1: Benefits of LCCS (% of respondents reporting benefits)	3
Figure 2: Cost Savings Achieved via LCCS	7
Figure 3: Average Percent of Total Spend with Low-Cost Country Suppliers	8
Figure 4: Average % of LCCS Spend	8
Figure 5: Final Destination of Goods and Services Procured in Low-Cost Countries	9
Figure 6: Who is Responsible for Low-Cost-Country Sourcing?	9
Figure 7: Leading Spend Category Criteria for LCCS	10
Figure 8: Top Five Categories Procured via Low Cost Country Sourcing	11
Figure 9: Top Five Countries with Established IPOs	11
Figure 10: External Services Being Used to Support LCCS Strategies	16
Figure 11: What Companies Are Doing to Mitigate LCCS Risks	20

Tables

Table 1: PACE (Pressures, Actions, Capabilities, Enablers)	4
Table 2: Options for Creating Local Presence in a Low-Cost Market	13
Table 3: LCCS Competitive Framework	22
Table 4: LCCS Decision Framework	28
Table 5: PACE Framework	36
Table 6: Relationship between PACE and Competitive Framework	36



Chapter One: Issue at Hand

Key Takeaways

- Continuous pressures to reduce prices and expand markets are forcing enterprises to seek new sources of supply in low-cost countries and regions.
- While LCCS offers major benefits of reduced cost and new market penetration, it also requires significant resources and creates new risks.
- An enterprise that efficiently executes LCCS will gain a global competitive advantage.

“We are reenergizing our global sourcing efforts. While we’ve had an effective approach in purchasing for a number of years, our move to a global product development system, accompanied by the emergence of excellent supply capability and lower-cost markets, provides us with some real cost-savings opportunities.” – General Motors CEO Rick Wagoner, in an address to GM stockholders, June 7, 2005.

Businesses of all sizes face new and quickly shifting mega-forces that affect the basic way business is conducted and, like General Motors, they’re altering their supply strategies accordingly. These forces include pricing, globalization, and supply chain dynamics.

- **Pricing:** An evolutionary change has taken place in the pricing of products and services. Businesses no longer can operate using the pricing rules of the past, when rising costs simply were passed through the supply chain to the end user. Today, end users expect the prices they pay to decline each year, even if energy costs and other costs are rising. Enterprises must continuously find ways to reduce costs year after year.
- **Globalization:** Companies now compete globally, and the potential rewards for winners continue to expand as undeveloped countries are integrated into the global market. Companies that don’t expand into new markets will see market share and profitability erode.
- **Supply chain:** The competitive framework of supplier-versus-supplier/product-versus-product has shifted to supply chain-versus-supply chain. Enterprises that can create efficient, collaborative, and flexible supply chains gain a competitive advantage not only for themselves, but also for their supply chain partners.

Competitive Framework Key

The Aberdeen Competitive Framework for LCCS defines enterprises as falling into one of the three following levels of practices and performance:

Laggards (30%) — no goods or services are procured via LCCS; little knowledge of foreign suppliers and supply markets

Industry norm (50%) — 1-20% of total spend via LCCS, practices and knowledge represent the average or norm

Best in class (20%) — more than 20% of total enterprise spend via LCCS; practices that are achieving competitive market advantage



Aberdeen's research report, *The CPO's Agenda* (March 2005), showed that LCCS is among the leading strategies supply management executives have prioritized for the next three years. LCCS not only can significantly reduce the cost of procured goods, it also can establish supply closer to end markets and help penetrate new markets.

PACE Key — For a more detailed description, see Appendix A

Aberdeen applies a methodology to benchmark research that evaluates the business pressures, actions, capabilities, and enablers (PACE) that indicate corporate behavior in specific business processes. For LCCS, these terms are defined as follows:

Pressures: Strong and continuous cost pressures have forced enterprises to reduce total costs. Suppliers in low-cost countries can offer goods and services at significantly lower cost prices than suppliers in more developed countries and regions can because their costs are very low.

Actions: Supply management organizations seek to source goods from low-cost countries and export them to other global operations.

Capabilities: Knowledge of foreign supply markets, sourcing skills, and processes that can execute LCCS.

Enablers: Consultants, service providers, and other third-party sources of intelligence on foreign supply markets.

But LCCS is a very complex initiative that presents significant risks that must be mitigated. Suppliers in low-cost countries often need development in basic engineering, manufacturing technology, and logistics capability. Also, supply chain infrastructure such as roads and ports are often poor. And partially offsetting LCCS cost savings are tariffs, taxes, duties, and other costs associated with sourcing from offshore suppliers.

Effective LCCS requires ongoing intelligence of foreign supply markets and foreign suppliers. Each low-cost country presents communications challenges, and local cultures and business processes must be understood and followed for successful LCCS.

Despite the risks and challenges, LCCS makes a compelling case for all enterprises.

The Compelling Case for LCCS

Today, it's no longer a question of whether a business should consider LCCS, it's a matter of how to launch, execute, and alter

LCCS to maximize benefits and minimize risks. The primary motivator for and benefit of LCCS is cost reduction (Figure 1). In fact, many procurement executives view LCCS as one of the most effective alternatives to combat rising energy and transportation prices and inflationary pressures in traditional and more established supply markets. Cost benefits reported by Aberdeen's study participants include:

- Reduced cost of procured goods and services by nearly 30%;
- Inventory cost savings average nearly 12%; and
- Logistics cost reductions of more than 10%.

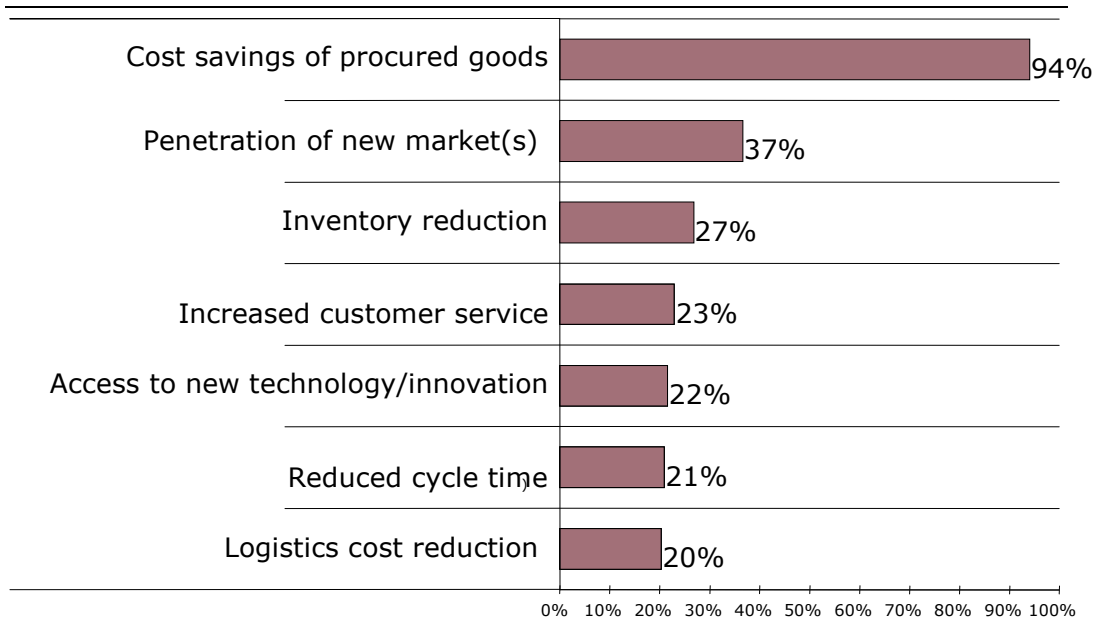
LCCS spend volume relative to total enterprise spend is a key performance indicator of LCCS performance. Enterprises that procure 20% or more of their total spend via LCCS gain significantly more savings than enterprises that procure less than 20% via LCCS, as shown in Figure 2 in the next chapter.

Additional benefits reported from LCCS initiatives include:



- Penetration of new markets: By establishing local supply lines to support local manufacturing and meet requirements such as local content rules, LCCS paves the way for future sales into that particular country and neighboring regions.
- Reduced inventory and cycle time, improved customer service: Establishing sources of supply closer to customers in foreign markets reduces inventory levels and cycle times, and logistically improves service to local customers.
- Access to new technology and innovation: Foreign suppliers sometimes possess or develop technology and innovative products before competitors in other parts of the world do. Having a local presence increases access to such innovation and the opportunity to use it for competitive advantage.

Figure 1: Benefits of LCCS (% of respondents reporting benefits)



Source: [AberdeenGroup](#), June 2005

Pressures, Actions, Capabilities, Enablers (PACE)

Aberdeen research shows a clear relationship between the pressures companies identify and the actions they take - and their subsequent competitive performance. Table 1 provides a prioritized PACE framework that reflects market pressures driving enterprises to adopt LCCS, and the process, organizational, and solution alignment enterprises are using to address these pressures.

**Table 1: PACE (Pressures, Actions, Capabilities, Enablers)**

Priorities	Prioritized Pressures	Prioritized Actions	Prioritized Capabilities	Prioritized Enablers
1	Continued pressure to reduce costs	Investigate cost-savings opportunities from suppliers in low-cost countries	Use internal or external knowledge to assess LCCS opportunity	Systems that can be used to collect data and other information on foreign supply markets
2	Penetrate new geographical markets	Establish new market presence by sourcing from that market	Establish international purchasing offices (IPOs) in new markets or regions	Information systems that provide foreign market insight and intelligence
3	Reduce inventory-carrying costs	Establish sources closer to foreign points of use	Foreign market knowledge, capability to build capacity or outsource in foreign market(s)	Solutions that provide insight into material usage patterns in foreign market
4	Improved customer service for customers in foreign markets	Establish presence in foreign market(s)	Knowledge of customer expectations in local market	Systems that are used to collect customer data related to service-level expectations
5	Access technology or innovation available only from low-cost markets	Establish presence in foreign markets; expand knowledge of supply bases in those markets	Knowledge of foreign supplier capabilities	Database and other solutions that provide data specific to capabilities of suppliers located in various countries or regions

Source: [AberdeenGroup](#), June 2005



Rising Material Costs Push Altec to Expand LCCS

Altec Industries, a privately held manufacturer of aerial devices, digger derricks, and specialty equipment for the electric utility, telecommunications, and tree care industries, was experiencing the pain of rising steel prices last year. Director of Materials and Logistics Dennis Rasmussen and executive management at Altec made a strategic supply management decision: “We had to do something different,” he recalls.

At that point, Altec had only “dabbled” in buying metal castings from China and Korea, Rasmussen says. He had known John Kamauff of Archstone Consulting (Stamford, Conn.) for years, and knew he had deep knowledge of foreign supply markets and low-cost country sourcing (LCCS). Rasmussen contacted Kamauff, and Archstone and Altec began working together on an LCCS strategy that addressed their desire to buy from low-cost countries and their overarching strategy of buying, selling, and designing globally.

The Altec/Archstone team examined the company’s direct and indirect materials spend and identified major commodities in which LCCS could reap significant savings. They prioritized their strategy in three “waves” that would take nearly 18 months and garnered the requisite cross-organizational and cross-functional senior executive support from around the company. The first wave includes four or five families of direct materials, plus two or three categories of goods currently purchased from distributors or brokers. The second and third will include other commodities that may be suited for LCCS.

“While we were working on the first-wave strategy,” says Rasmussen, “we realized that we needed someone who was very knowledgeable not only on global sourcing but specifically on highly engineered products like ours.” Archstone Consulting’s Kamauff recommended Altec contact First Index, a Whippany, N.J., firm that connects global buyers and suppliers of custom-manufactured, highly engineered products. First Index identified several potential Chinese suppliers for the Altec/Archstone Consulting team that are being evaluated.

Altec’s criteria for commodities to be shifted to low-cost country suppliers are typical of most companies considering LCCS: Total landed cost savings must be at least 20%.

“You’ve got to pay what I call the ‘hassle factor,’” says Rasmussen. “If pricing alone is 40% lower, you’re probably going to lose about 15% of that savings to get the materials to the U.S.,” taking into account taxes, tariffs, duties, logistics costs, and “hidden” LCCS costs that often arise.

Altec is taking various steps to mitigate the inherent LCCS risk including having all foreign suppliers sign a non-disclosure agreement (NDA) before sharing any information. “But we still have a concern about IP” (intellectual property). So, Altec has reduced that risk by sourcing components, and not finished products, from Chinese suppliers. “They would not be able to copy everything,” says Rasmussen. “I feel we’re protected.”

The risk varies greatly according to the type of product sourced, Rasmussen points out. Hydraulic cylinders are an example. “There’s huge liability risk with these cylinders.



Rising Material Costs Push Altec to Expand LCCS

Current suppliers must have liability insurance, and we are not going to be able to get that in China.” But he doesn’t rule out sourcing cylinders or cylinder components in China in the future.

According to Kamauff, “It is also important to note that incumbent suppliers have every opportunity to participate as well as benefit throughout this process. Rationalization will undoubtedly occur, and Altec’s best suppliers will survive and even prosper; some of them may also be moving into low-cost countries with Altec’s support and guidance, where and when it makes sense.” Rasmussen adds, “If we can develop alternative world-class sources, it will mitigate some of the risk. We will identify potential sources for the cylinder components, and jointly decide with our incumbents if this is an area in which we want to move forward.”

The LCCS goal is to procure \$20 million in goods in three years, which would represent about 15% to 20% of Altec’s total spend.



Chapter Two: Key Business Value Findings

Key Takeaways

- LCCS is being used to achieve cost savings across a broad range of goods, from basic raw materials to complex engineered parts and sub-assemblies.
- Despite having strong interest, most companies have not established a strategic plan for LCCS that's aligned with the overall business strategy.
- Some level of presence in foreign supply markets is required for LCCS success.

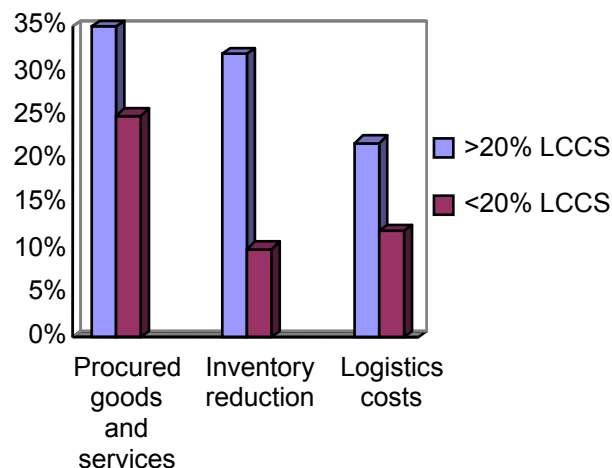
LCCS is now on the radar screen of enterprises of all sizes, in all industries. By its very nature, LCCS is complex and touches nearly every aspect of operations to some degree. Though executed by procurement/supply management, LCCS, when done correctly, is a cross-functional initiative, *led* by supply management but not necessarily *executed* by supply management, at least at the transactional level.

LCCS Trends and Implications

“More is more” when it comes to LCCS. Aberdeen research results reveal that enterprises in which LCCS represents more than 20% of the total spend realize a significantly higher percentage of savings from procured goods/services, inventory reduction, and logistics costs (Figure 2).

This research result alone makes an extremely strong case for shifting a significant portion of enterprise spend to suppliers in low-cost countries. Enterprises that use LCCS for more than 20% of their overall spend enjoy cost savings of 35%, compared to sourcing these goods and services from high-cost countries, while enterprises that use LCCS for

Figure 2: Cost Savings Achieved via LCCS



Source: AberdeenGroup, June 2005

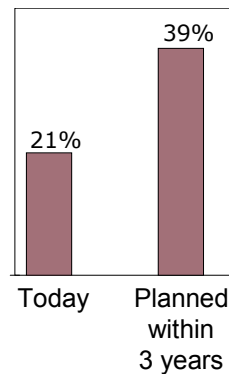


20% or less of total spend report 25% cost savings. For \$1 billion in total spend, this difference in savings is \$350 million versus \$250 million. In other words, enterprises that Aberdeen defines as best-in-class in LCCS achieve 40% more cost savings in procured goods and services than companies using LCCS for 20% or less of total spend. These companies also enjoy greater inventory cost reduction (32% versus 10%) and logistics cost reduction (22% versus 12%). Of course, companies that do not use LCCS at all have significantly higher costs than best-in-class and average LCCS players.

Other significant research findings include:

- Overall, procurement executives indicated their companies plan to nearly double total spend with low-cost country suppliers over the next three years (Figure 3).

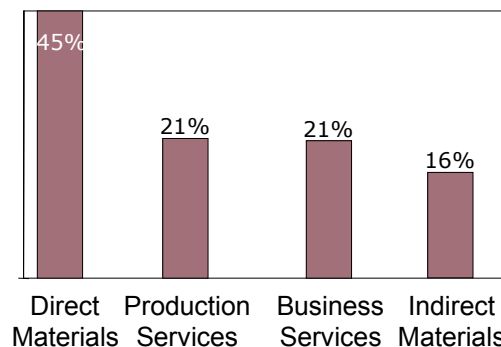
Figure 3: Average Percent of Total Spend with Low-Cost Country Suppliers



Source: [AberdeenGroup](#), June 2005

- LCCS efforts have focused mostly on direct (production) goods and materials (Figure 4).

Figure 4: Average % of LCCS Spend

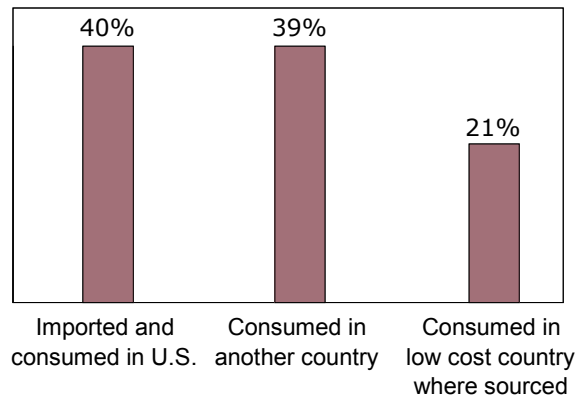


Source: [AberdeenGroup](#), June 2005



- The vast majority (nearly 80%) of goods sourced via LCCS are exported to other countries for consumption (Figure 5).

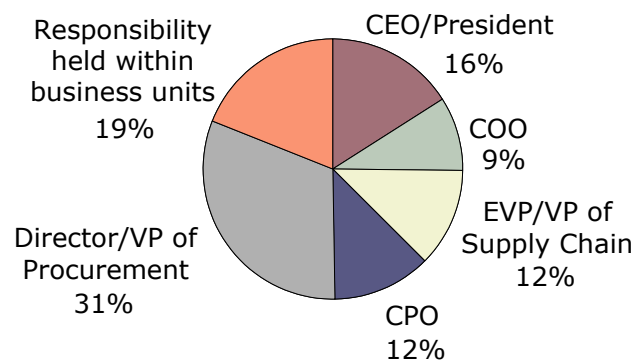
**Figure 5: Final Destination of Goods and Services
Procured in Low-Cost Countries**



Source: **AberdeenGroup**, June 2005

- Procurement (supply management) professionals take the lead on LCCS initiatives at most enterprises, with 43% of enterprises reporting that either the chief procurement officer (CPO) or director/VP of procurement heads LCCS efforts. Nearly one-fifth of enterprises report that responsibility is held within individual business units (Figure 6).

Figure 6: Who is Responsible for Low-Cost-Country Sourcing?



Source: **AberdeenGroup**, June 2005



- Competitiveness in the specific supply market (79% of respondents) and labor cost (73%) are the leading criteria for considering a spend category for LCCS, further reflecting the fact that cost savings is the leading reason enterprises consider LCCS (Figure 7).

Figure 7: Leading Spend Category Criteria for LCCS



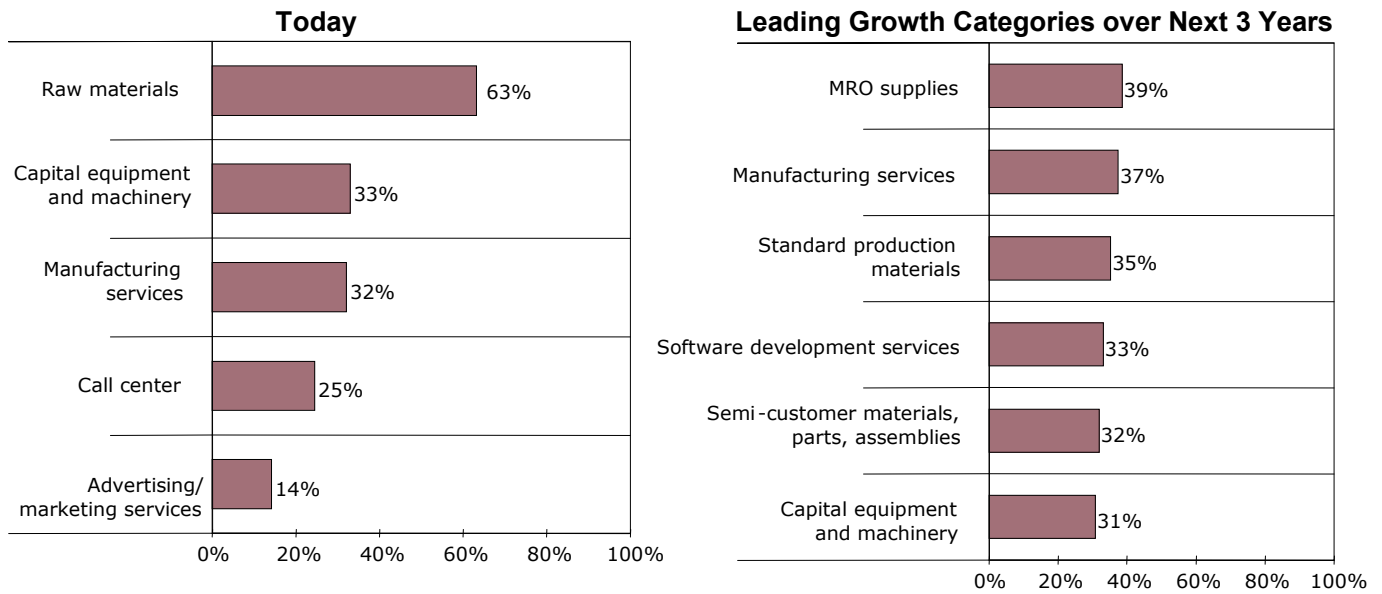
Source: **AberdeenGroup** June 2005

- Raw materials have been the leading spend category procured via LCCS. Over the next three years, enterprises will increase their buying of maintenance, repair, and operating (MRO) supplies from LCC suppliers more than any other single spend category (Figure 8).



- Manufacturing services has been the third highest LCCS spend category to date, and will be the second-fastest growing over the next three years (Figure 8).

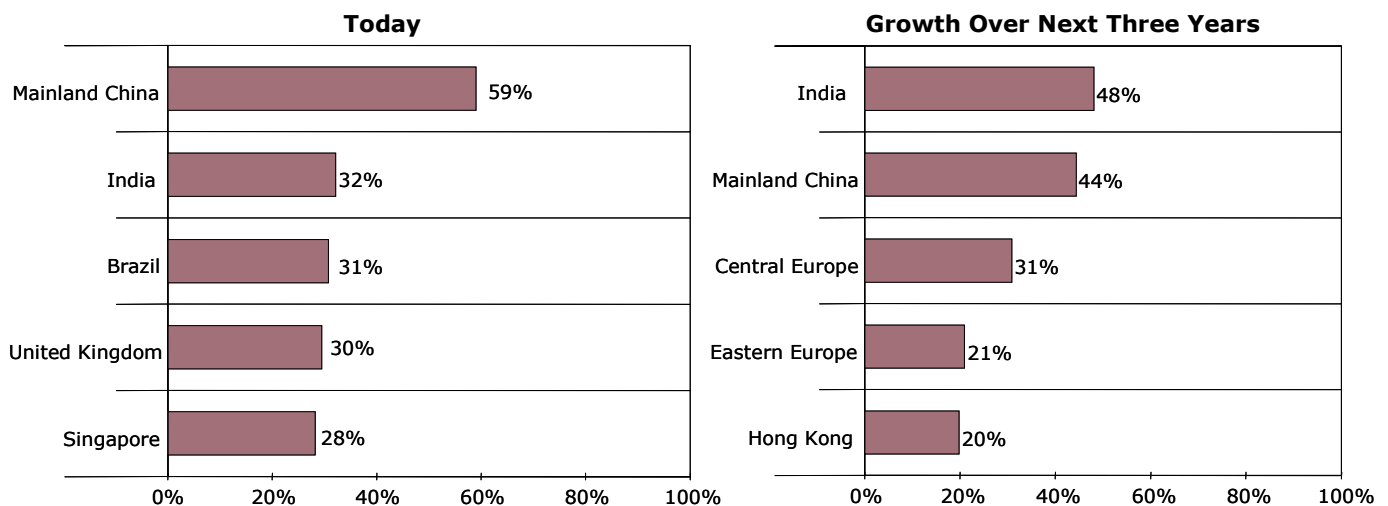
Figure 8: Top Five Categories Procured via Low Cost Country Sourcing



Source: **AberdeenGroup**, June 2005

- China and India are, by far, the leading low-cost countries. More enterprises have established IPOs in China and India than in any other country, and they're the two leading low-cost countries targeted for new IPOs over the next three years (Figure 9).

Figure 9: Top Five Countries with Established IPOs



Source: **AberdeenGroup**, June 2005



Outsourcing the IPO Saves Big Bucks for Safety Products Producer

A manufacturer and distributor of personal protective equipment, first-aid products, and hazardous material storage cases had sourced some products from Taiwan and China for many years, and has worked with Archstone Consulting on sourcing, costing, inventory, and corporate branding strategies. A key to the company's LCCS strategy was outsourcing the creation of international purchasing offices (IPOs) in China and Taiwan.

The company's president reports his firm sources safety products, industrial products, and electrical products from low-cost country suppliers. The chief benefit is the usual one: major cost savings, estimated at 10% to 50%.

About nine years ago, the firm contracted a service company in China to establish IPOs in China and Taiwan. Benefits of outsourcing the IPOs, in the words of the safety products company's president: "Our costs are literally a few percentage points of the costs of running a normal IPO. We fund the cost of the office and the operating expenses, and we fund the cost of the employees, but we can increase or decrease staff as we see fit, and they are not on our payroll. We avoid local issues including taxes. It's a very low-cost model."

The IPO also serves a sales function for the North American company, which plans to double or triple its LCCS program over the next two years.

Presence in Foreign Markets

Early movers in the LCCS arena have been quick to point out that presence in foreign supply markets ("feet on the street") is essential for success. Supply management executives interviewed by Aberdeen agreed that LCCS cannot be effectively executed from a remote location in the U.S. or Europe. LCCS involves many steps – accessing supplier technical and manufacturing capabilities, clear communication of product specifications to suppliers, supplier qualification, sample or prototype testing, supplier implementation, periodic supplier audits, and supplier development, to name a few – that are difficult or even impossible to effectively execute without a local presence.

There are three ways to establish an in-country presence:

1. Create an international purchasing office (IPO) in-country or in-region.
2. Use agents or brokers that operate in low-cost regions.
3. Use one or more third-party firms to provide IPO resources and services, or to outsource the IPO itself.

Each approach has advantages and risks, which are summarized in Table 2.

**Table 2: Options for Creating Local Presence in a Low-Cost Market**

	Establish Dedicated IPO	Use Agents or Brokers	Use Third-Party Service Provider or Outsource the IPO
Benefits	• Full control • Complete ownership of acquired supply market knowledge	• Lowest up-front cost	• Lower cost than dedicated IPO • Faster realization of cost savings
Watchouts:	• Highest cost • Slow to realize cost savings • Hardest to exit	• Reduced cost savings • Higher risk of quality and delivery problems	• Limited development of internal LCCS skills

Source: **AberdeenGroup**, June 2005***'Build Your Own' IPO***

IPOs are remote offices established in low-cost countries or regions to procure goods and services from that market. IPOs generally are set up by larger companies that have the needed resources in the form of personnel or capital required to establish and operate an IPO. In fact, leading companies in the high technology and automotive manufacturing sectors have done much over the past 20 years to develop supply bases in low-cost countries, essentially blazing the trail that had led to today's strong migration toward low-cost country suppliers.

IPOs are expensive to establish and maintain. Sources indicate costs can reach \$1 million to \$2 million to establish even a small IPO (up to 10 people) in low-cost hot beds such as China, Hong Kong, or Taiwan. In addition, recruiting talent and establishing an in-country IPO infrastructure can take at least six months to a year. (Increased interest in LCCS is making recruiting and retaining in-country supply managers more challenging.) Once hired, these resources must be trained and begin developing local supply. As a result, enterprises that have established their own IPOs report it can take more than a year to see the first benefits from their LCCS initiatives.



Delphi Learns LCCS Lesson: When Developing Suppliers, There's No Substitute for Local Presence

Delphi Automotive learned a painful lesson when it launched its LCCS initiative: It's difficult if not impossible to manage offshore suppliers from halfway around the globe.

When it launched its LCCS initiative, the tier one automotive supplier tried to manage suppliers in low-cost countries from Delphi's headquarters in Troy, Mich., and other locations far from the low-cost regions. The goals were to help these potential low-cost suppliers get to the quality and volume levels needed to supply Delphi's local manufacturing sites in their respective countries, then provide support to the most capable suppliers to raise them to the level needed to supply Delphi's production requirements in North America and other relatively high-cost regions.

However, like other LCCS pioneers before it, Delphi quickly learned that the LCCS regions have immature infrastructure and supply bases and cultural variations that require close development and monitoring of suppliers. Bill Eagen, purchasing director in Delphi's Global Supply Management group, summarizes the remote supplier development efforts: "We proved that it is very difficult to achieve from remote locations."

"You must have people on the site locally to develop suppliers and ensure they can meet contract requirements," Eagen says, adding that buyers responsible for serving manufacturing requirements "were reluctant to take the chance" with low-cost country suppliers that were being developed remotely. "We missed the continued reservations by the buying organization in our divisions to get into those longer supply chains" that using LCCS would create.

To jumpstart its LCCS initiative, Delphi established IPOs in Latin America, South America, Asia, and Eastern Europe. "We now have 70 people in those IPOs," Eagen says, "and we're planning to add more." To ensure internal support for LCCS initiatives, Delphi ensured that IPOs were cross-functional, to include engineers, quality professionals, and experienced procurement personnel. "Their mission is to develop suppliers so they're capable [of receiving] RFQs and then eventually integrate the suppliers into our commodity teams, which are the purchasing teams within Delphi that make those sourcing decisions," Eagen says.

Other factors for Delphi's LCCS success include:

- **Up-front planning to ensure the LCCS strategy is sound.** "It's critical that the LCCS strategy is aligned with the overall business strategy," he says. In Delphi's case, strong support for LCCS in general, and investing in IPOs in particular, came from members of the company's Strategy Board, some of whom had experience in seeing the benefits LCCS could deliver. These board members believed Delphi had to accelerate its use of low-cost country sources, and they communicated that to R. David Nelson, vice president for global supply management, and his group. The board also approved the funding needed to set up the IPOs. "They provided the resources and they expect performance. Top-down support is a requirement" to make LCCS work, Eagen says.
- **Clear and frequent communication with remote business locations.** "The sourcing process at Delphi is somewhat centralized, but the company overall is highly decentralized. Individual businesses carry bottom-line responsibility, so they need input on sourcing decisions, including how to reduce the risk that comes with buying from suppliers



Delphi Learns LCCS Lesson: When Developing Suppliers, There's No Substitute for Local Presence

in foreign locations and creating longer supply lines [due to use of LCCS],” Eagen adds. “We did that effectively in North America, but maybe we didn’t do it sufficiently in other areas.”

- **Expect LCCS to take longer than planned.** Like most supply management pros who have dealt with LCCS, Eagen reports “it’s never fast enough; the education process takes longer” in low-cost countries. He advises others considering LCCS to “find ways to solve problems quickly.”
- **Supplier capabilities vary by region.** In assessing the supplier capabilities in various low-cost regions, Eagen reports Mexico and Asia are advanced in electronics and electrical supplies and “not a major problem” when it comes to quality issues with these spend categories. “The challenge in low-cost regions is ramping suppliers up to the volumes we need, which can be three or four times what they’re used to.”

In Central and Eastern Europe, quality can be a challenge, Eagen says, and many suppliers there don’t understand business requirements “that we accept here as everyday business; for example, warranties, schedules, currency issues, payment terms,” Eagen says. Suppliers in many of these countries also are accustomed to automatically passing price increases through to the final customer, and inflation in some low-cost countries can approach the 10-20% range.

Use of brokers/agents

Brokers and agents in low-cost countries essentially act as purchasers or distributors for clients, taking a percentage of each transaction as a service fee. Aberdeen’s research leads us to conclude that some agents and brokers in low-cost countries may provide high value, but enterprises should be careful and conduct heavy due diligence before using an agent or a broker as a key component of an LCCS strategy. To at least some degree, the vested interest of brokers and agents – i.e., getting a “cut” of any transaction – works against the basic value proposition of LCCS: cost reduction. In addition, using a broker/agent naturally blocks the visibility the buying organization can gain into a supply market and the forces that affect pricing and other key factors. Brokers typically are very limited in providing assurances to the buying firm of product quality and on-time delivery, and they provide little if any supplier management services.

Use of consultants and third-party firms

An alternative approach is to outsource the IPO to a qualified and experienced partner service provider. This approach can free up working capital, speed supplier development, and capture the cost and performance benefits of LCCS. Third-parties can access supplier capability, pre-qualify suppliers, help suppliers minimize logistics costs by consolidating shipments, estimate total landed cost, manage and even help develop suppliers.

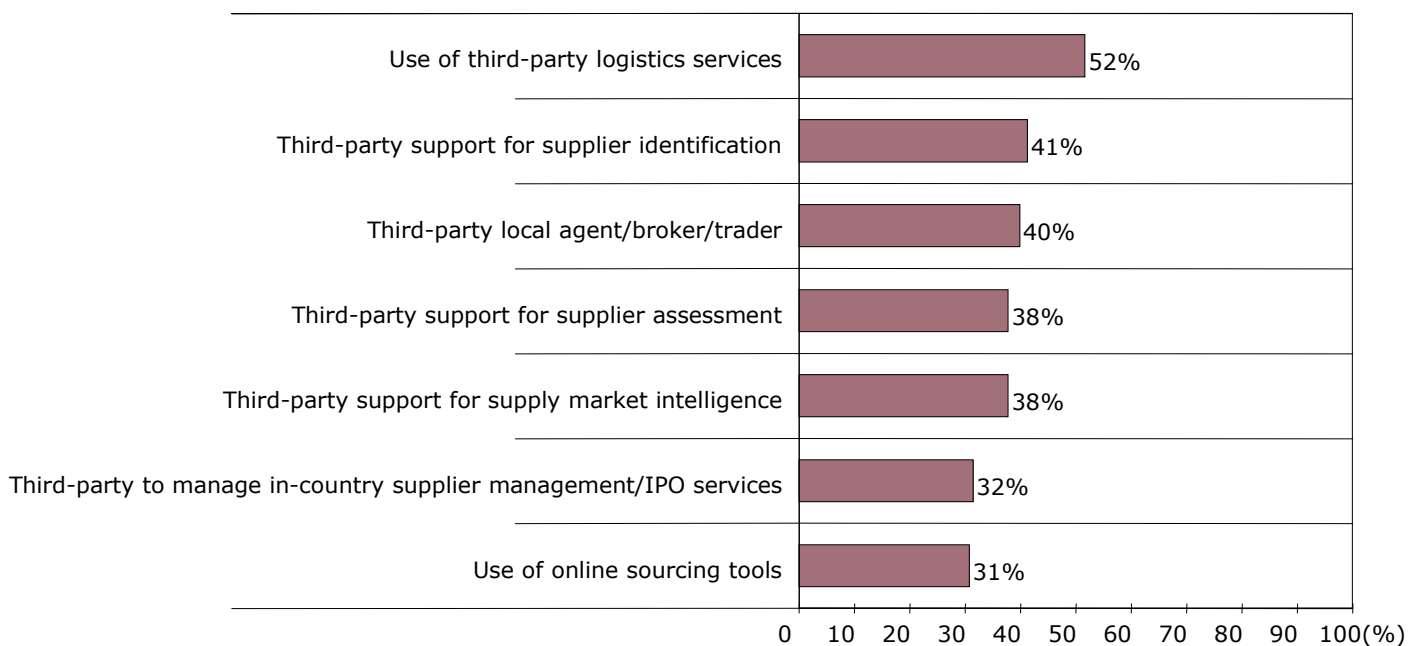


IPO services are provided by consulting firms, sourcing services firms, third-party logistics providers, or other third parties with LCCS knowledge and experience (Figure 10). Many already have infrastructure and staffing in low-cost regions and an established understanding of local suppliers, language, culture, and business practices. Such “out-of-the-box” resources can dramatically accelerate the time for enterprises to establish - and reap benefits from - low-cost region suppliers.

Using a third-party firm for IPO support can also lower the costs of an LCCS program and help the buying organization realize cost savings more rapidly. Most of these firms share infrastructure and services across multiple customers, allowing them to amortize the costs of building and running an IPO.

Using third-party service providers also enables an enterprise to “test the waters” of a particular low-cost country or region as a preliminary step to establishing its own IPO as it shifts more total spend to LCCS. Relying on a third-party also greatly simplifies and reduces the cost of exiting the low-cost country when market conditions change.

Figure 10: External Services Being Used to Support LCCS Strategies



Source: [AberdeenGroup](#), June 2005



Alcoa Rapidly Ramps up LCCS

Alcoa launched its LCCS program, which it calls “global competitive sourcing,” about a year ago. Supply management leaders at Alcoa cite a common theme among procurement groups that have deployed LCCS: Without top management support, the program would never have gotten off the ground.

But with that support and a sound strategic plan, Alcoa’s program stands poised to deliver significant value for years. Both CEO Alan Belda and CFO Rick Kelson actively supported the program and helped bring all business units into the fold. “We should be exploring whether there are savings to be secured by broadening our horizons to include suppliers from anywhere in the world,” Belda wrote in an internal letter in June 2004. And in a letter to business unit presidents, Kelson stated, “Every business unit president needs to review their specific plans to ensure appropriately aggressive multi-year plans and targets have been developed and appropriately resourced.”

Alcoa’s LCCS team is led by Jim Szilagy, director of global supply management solutions and services; Sourcing Manager Doug Sparks, and Procurement Consultant Kelly Lipski, formerly of FreeMarkets. The Alcoa team believes it’s in the early stages of LCCS, which is accurate, especially compared with more experienced global sourcing teams in other industries, notably automotive manufacturing. However, Alcoa has rapidly made progress in LCCS and is much further down the learning curve than the vast majority of manufacturing companies are, especially raw materials manufacturers.

When Alcoa launched the program, some business units in China and other low-cost countries had already had been buying from local sources to support local manufacturing operations, Sparks notes. “But in terms of importing materials, there was very little traction.” Ten percent of Alcoa’s 2004 spend was sourced from low-cost countries in 2004, and the majority of this still supports local manufacturing requirements. But Alcoa considers low-cost countries for all its sourcing opportunities.

Cost savings are the main driver behind the program. Based on internal research and external sources, Alcoa has targeted what it considers the benchmark of 30% cost savings versus sourcing from domestic suppliers or high-cost countries. Most of these projected savings result from lower labor costs, but lower materials cost also contribute significantly. Alcoa has targeted a three-year savings goal of \$1.2 billion from overall cost-reduction efforts, and LCCS is expected to be a significant contributor in reaching that target. Procurement is responsible for half of the \$1.2 billion savings goal.

Direct materials such as chemicals and basic metals used in aluminum manufacturing were the initial commodities targeted for LCCS, but indirect materials are now included in the program. “That’s where we’ve focused and improved,” Sparks says. In addition to chemicals and metallic raw materials, sourced categories include consumer goods such as plastic bags, cartons, cutters, and foils; electronics; various types of components; and even engineering and information technology services.



Alcoa Rapidly Ramps up LCCS

The initial regional focus of the program was China and India, but Alcoa is now sourcing significant volumes from many other low-cost countries, including Ukraine, The Czech Republic, South Korea, Thailand, Taiwan, Vietnam, Brazil, and other South American countries.

Feedback from business units has been very positive, according to Sparks and Szilagy. Lipski spends a lot of time at individual business units, educating them on best practices and working closely with them. But results can vary dramatically from one business unit to the next. "The program really isn't a business unit initiative," Szilagy says. "But if the procurement people are tied into the strategy of the business unit, Kelly has more traction."

Technology has played an important role in Alcoa's program. Ariba tools are used for online bidding, which the Alcoa team notes has helped provide fast and accurate feedback to suppliers about the competitiveness of their bids, information they were not otherwise receiving in a timely manner. Sparks notes that procurement personnel needed significant training, which will continue, especially in the area of calculating total cost of ownership (TCO).

Though Alcoa's program is still relatively new, it has learned many lessons, and the education process continues. As nearly every LCCS practitioner participating in this Aberdeen research study notes, each individual step of the sourcing and procurement process takes longer when dealing with low-cost country suppliers. TCO is more complicated in LCCS, and TCO calculations should be estimated as early as possible in the sourcing cycle and updated frequently. The Alcoa supply management team stresses that much attention be focused on learning - in detail - all compliance requirements in each individual country, and that companies understand local cultures and laws. Miscommunication is always a possibility in LCCS, so Alcoa recommends following up verbal communications with e-mails.

The Alcoa supply management team has a strategy to expand and improve its program in several areas:

- Buying leverage remains regional, but plans are in place to ensure procurement can exert global leverage in many key spending categories.
- Alcoa is developing a formal education and training program for all buyers.
- The company developed new capabilities in supplier identification and qualification in China and India in 2003. Similar tools will be created for Eastern European and Latin American suppliers.
- Key performance indicators (KPIs) for procurement and individual business units will be established to track LCCS progress.
- Automated tools specific to LCCS challenges will be developed, including tools that incorporate social responsibility into supplier selection.



Mitigating LCCS Risks

Risk mitigation is one of the most important components of any LCCS program. LCCS risk includes:

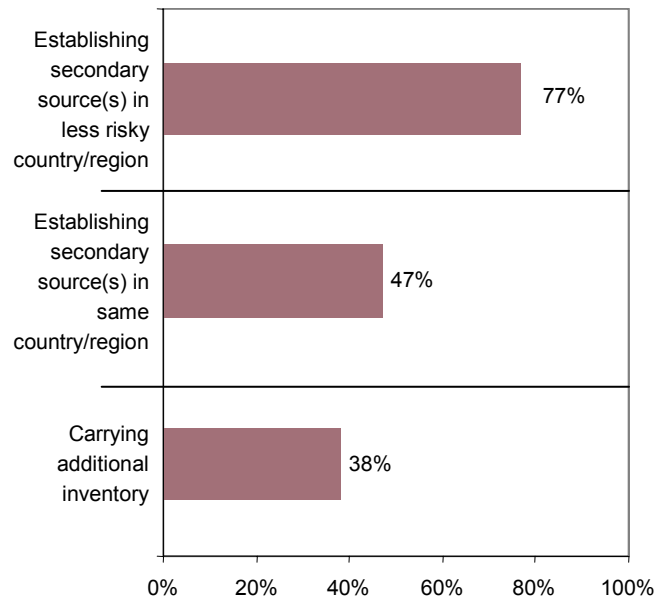
- ***Supply disruption:*** Generally, suppliers in low-cost countries are not as mature and advanced as suppliers in more developed countries and regions. Poor infrastructure can create logistics problems, and communications with suppliers can be time-consuming and sometimes inaccurate. Any of these factors can lead to supply disruptions and a subsequent negative effect on manufacturing and other operations.
- ***Long lead times:*** Immature suppliers and developing infrastructures tend to make lead times longer in nearly all low-cost countries.
- ***Poor quality:*** Many suppliers in low-cost countries are not capable of supplying products at the needed quality level. Some enterprises (typically large manufacturers) spend considerable time and resources developing suppliers in low-cost countries.
- ***Security issues:*** Some low-cost countries have high levels of political instability and potential terrorist activity.
- ***“Hidden” costs:*** Tariffs, duties, and taxes sometimes change dramatically and quickly in low-cost countries.

Supply executives must constantly monitor these risk factors and evaluate trade-offs between costs, performance, and risks. Enterprises interviewed by Aberdeen report mitigating low-cost country supply risks using a myriad of tactics, with the most frequently used shown in Figure 11.

Other risk-mitigation steps include supplier development, spot audits, buffer lead times, and alternative sourcing scenarios and allocations. For example, one major furniture manufacturer reported dramatic cost benefits from sourcing the bulk of its wood from Eastern Europe. Lumber is exported from Eastern Europe to the company’s manufacturing sites around the world. However, delivery and lead times from this low-cost source are unpredictable. To maximize the savings of lower-cost materials and ensure supply stability, the furniture producer has maintained sources in developed countries with more reliable delivery closer to its manufacturing sites.



Figure 11: What Companies Are Doing to Mitigate LCCS Risks



Source: **AberdeenGroup**, June 2005

No Secrets About Key to LCCS Success at Valmont Industries: Communication

Valmont Industries started an LCCS program in China in July 2003. The manufacturer (\$1 billion in annual sales) of engineered support structures, coatings, tubing, and irrigation products has already seen \$3 million to \$4 million in cost savings. The secret to Valmont's success? Clear and frequent communications with internal stakeholders and low-cost country suppliers, according to Wally Pasko, vice president of corporate purchasing.

That communication is critical, especially in China. "The Chinese products are outstanding, but communication is difficult," Pasko says. "If you don't have people on the street, you will fail." And it's not necessarily procurement professionals who are needed "on the street," but engineers and other technologists, according to Pasko. "You've got to convince the Chinese that you are not a one-time player. It takes time for them to trust you. The relationship must be nurtured." Before Valmont began its LCCS program, it relocated an employee to China.

Internal communication about the sourcing process is also critical. Internal customers of the procurement organization should be continuously advised on the status of a particular sourcing project but also its priority level compared with those of other active projects. If Valmont were to start its LCCS program all over again, Pasko says, the company would "over-communicate."



No Secrets About Key to LCCS Success at Valmont Industries: Communication

The purchasing group holds weekly meetings with the various divisions involved in the LCCS program to provide detailed updates. “You really have to micro-manage the program, much more so than with domestic suppliers,” Pasko says.

Valmont attributes the millions in savings to the open communication approach. “We don’t consider projects with less than 30% savings,” Pasko says. “We’ve seen savings as high as 80%” compared to domestic sources.

Valmont’s primary LCC sources are from China and India, but the company is closely examining Eastern Europe. Pasko notes Slovakia is “not that far behind China, cost-wise, and India is right behind China as well. We have to make sure we have our downside covered, so we look all over.”

A major focus of the program is to support local manufacturing facilities. The company has a plant in China and is building another. “We’re making sure our supply chain is aligned,” Pasko says.

Other factors contributing to the success of Valmont’s program include:

- **Securing company alignment and resolving issues quickly.** LCCS has been “good for our company, but there certainly are internal challenges that must be overcome,” Pasko says. “[Any LCCS initiative] goes through a more rigorous process than domestic sourcing. You have to make sure that you can handle the bid process and that you close the loop on the entire sourcing process.” As in other successful LCCS programs, top management support was critical. “The key is to have senior management support,” Pasko says. “Without that, you will fail. The first year of the program was tough, but our chairman helped make it happen.”
- **Plan on taking longer than planned.** Pasko discovered that in LCCS, everything takes longer from program and supplier development to delivery cycle times. “Management thought it would take six weeks, but it took about 16 weeks” to get the program going, he says. He adds that lead times from China stretch out as long as nine weeks, which means Valmont must hold extra inventory. And launching the LCCS program took a lot of time.
- **Design a strategy to protect IP.** Intellectual property concerns can be a challenge, particularly in China. To protect its IP, Valmont has adopted the approach of sourcing components from Chinese suppliers, but not completed products.



Chapter Three: Implications & Analysis

Key Takeaways

- LCCS presents significant savings and other opportunities for enterprises, but it also presents tough questions that must be addressed (see Chapter One).
- LCCS execution requires investment and time before savings and other benefits are realized.
- Best-in-class enterprises establish strong presence in strategic foreign supply markets.

As shown in Table 3, survey respondents fell into one of three categories – Laggard, Industry Average, or Best in Class — based on their characteristics in four key categories:

- (1) Process (ability to gather foreign supply market information and act on it);
- (2) Organization (alignment of procurement and other functions to gain LCCS benefits);
- (3) Knowledge (visibility into foreign supply markets); and
- (4) Technology (scope of cost modeling and readiness to apply procurement and sourcing automation to LCCS efforts).

In each category, survey results show enterprises exhibiting best-in-class LCCS characteristics also enjoy the significant cost savings and other benefits LCCS can deliver.

Table 3: LCCS Competitive Framework

	Laggards	Industry Average	Best in Class
Process	• No standardized procedures for sourcing and managing foreign sources of supply.	• Standardized sourcing procedures applied to LCCS; but inconsistent approaches to managing LCC suppliers.	• Standardize procedures for sourcing and supply management employed directly or by third-party.
Organization	• No local presence in low-cost regions. LCCS not coordinated between supply chain, procurement, and logistics.	• Small but growing presence in a limited number of low-cost markets - either directly or through third-party. Some cross-functional coordination on LCCS sourcing decisions.	• Well-established IPOs in multiple LCCS markets – either directly or through a third party. LCCS strategy and operations coordinated across multiple supply, operations, manufacturing and finance functions.



	Laggards	Industry Average	Best in Class
Knowledge	Limited knowledge of foreign supply markets, landed costs, or LCCS value/risks.	- Development of LCCS supplier-capabilities database and monitoring of key supply markets. - Basic understanding of trade compliance and landed costs. - Periodic insight into LCCS operations.	- Comprehensive and current database of LCCS supplier capabilities and supply markets across all strategic spend categories. - Proactive monitoring of trade, tariff, and landed costs. - Constant monitoring of LCCS operations and performance.
Technology	Little or no automation of sourcing or operations. Spreadsheet-based reporting and analysis.	- Use of basic online negotiations and electronic communications with LCC sources. - Use of basic reporting and analysis tools.	Use of broad e-sourcing platform, including negotiations, project management, and advanced optimization-based analytics.
Performance	- Little or no monitoring of LCCS performance. - No current spend with LCC sources.	- LCCS performance examined on a quarterly basis. 20% or less with LCC sources.	- Constant monitoring of LCCS costs and performance. - More than 20% spend with LCC sources.

Source: [AberdeenGroup](#), June 2005

The PACE framework is one way to examine current pressures and how enterprises can respond to them through actions, capabilities, and enablers. However, the framework presents a clear, logical, and accurate framework from which a company can weigh appropriate reactions to pressures.

At P&G, LCCS is a Company Strategy, *not* a Procurement Strategy

Procter & Gamble (P&G) has been sourcing from low-cost countries for decades. However, the global consumer products giant redoubled its LCCS initiatives in 2000, when A.G. Lafley took over as CEO and accelerated the company's move into new global markets and product segments.

Prior to Lafley's arrival, P&G's business focused on the premium segment (i.e., highly developed) of the consumer products market. Lafley challenged that strategy and pushed P&G to serve "all the world's markets." So, P&G restructured and started to compete in immature and undeveloped markets. "The intent was to serve all the world's customers, to make their lives better every day," says Alfredo "Jet" Antonio, director of purchasing at P&G's Cincinnati headquarters.

Antonio says the key to P&G's success is that LCCS "is more a company strategy, not a procurement strategy." Because P&G now manufactures and sells products in all major global markets, it's essential that supplies be sourced close to where they're marketed and consumed.



At P&G, LCCS is a Company Strategy, *not* a Procurement Strategy

China has been a long-time focus for P&G, which began manufacturing in the country in 1988 through a joint venture with a Chinese soap manufacturer. At that time, nearly all purchased materials were imported into China to support this venture. “Establishing LCCS was almost a ‘no-brainer’ then because import duties in China were 125%, and we could not afford to pay that level of tariff on a sustained basis. There was no choice but to localize supply,” Antonio says. Since then, China’s tariff structure has come more in line with that of the rest of the world.

In those early days in China, quality issues were a major challenge, so P&G made supplier development a top priority. “No supply base in China could meet our standards at that time,” says Antonio, the first P&G employee assigned to China. His mission: Establish a P&G purchasing operation in country. He recruited and trained Chinese employees in professional purchasing practices, and was also charged with developing a localized supply base, which required significant training, time, and effort. To accelerate manufacturing ramp up, P&G purchased equipment for some suppliers.

“There was a lot of hand holding by our technical quality team,” says Antonio, adding that P&G has “rigorous” quality standards. Antonio and his team trained suppliers about P&G’s quality program and materials specifications. They conducted plant audits, which many suppliers failed. But the process uncovered improvement opportunities, so suppliers developed action plans for improvement.

Acquiring low-cost, good quality materials was a chief goal. But P&G’s larger goal was to support local manufacturing needs, which were growing rapidly. “In the mid- to late-1990s, we launched what we called our ‘gold mine’ program, which helped us discover a lot of sources of supply for materials we use in our laundry business,” Antonio says. Over time, P&G began to fully leverage the low-cost supplies from China. “We started exporting these materials to other regions,” Antonio adds. The exporting effort from China grew to include packaging and perfume ingredients, which are exported to developed markets such as the U.S., Europe, Japan, and even Southeast Asia. Other business units are also involved in receiving low-cost materials from China, including beauty care, P&G’s largest business in Asia.

Antonio began localization efforts in packaging, a spend category that typically includes a high number of potential suppliers. In its Chinese manufacturing operations, P&G has localized all packaging suppliers, some commodity chemical suppliers, and about half of all materials suppliers overall.

P&G’s purchasing group aimed to reduce costs via LCCS, but the program produced many other benefits, including the ability to add manufacturing capacity in the specific market where it’s needed, and to create competition within the supply base. Antonio reports that suppliers in other global regions have reacted to the low-cost competition from Chinese suppliers by keeping their pricing more competitive. He also notes that prices have recently risen in China, partly due to problems with energy production capacity there. “It’s equalizing, to a degree,” Antonio says. “We are reassessing some of our sourcing strategies for major materials.” The lesson? Low-cost countries



At P&G, LCCS is a Company Strategy, *not* a Procurement Strategy

don't remain low-cost countries forever. As their economies grow and demand rises, macro-economic forces tend to push prices up.

P&G's search for low-cost solutions has expanded into new categories of spend, including capital equipment from China and India, low-cost molds, tooling for plastic packaging, and even local contract manufacturing. P&G actually imports some of its own finished products from China, such as the Crest "spin brush." And service centers, including IT service, have been established in low-cost countries such as The Philippines and Costa Rica, and technical centers have been set up in Caracas and Beijing. "We've invested in our people on the ground in the markets we want to grow most rapidly," Antonio says.

Bottom line: P&G's early entry into China via its sourcing group has paid off in a big way for the company. "The amount of investment that went into China in the 1990s was incredible," Antonio says. New equipment was flowing into the country rapidly, and manufacturing capacity rose quickly. "The 1990s were ripe for mining the opportunity in China," Antonio says. And P&G was ideally positioned to benefit, largely due to its early sourcing presence there.

Process and Organization

Different enterprises approach LCCS in different ways, but those that have achieved the most success share common processes and organizational structures. Approaches vary based on company size and available resources.

- Best-in-Class enterprises include LCCS in all major strategic planning and decision-making activities, including processes normally outside the realm of supply management, such as new market identification and expansion and balance of trade initiatives.
- Best-in-class enterprises deploy resources to low-cost countries (or hire third-parties with established resources) to develop and otherwise work with suppliers to improve business processes, develop technology, and improve performance to levels required to support local customers and customers in remote, high-cost countries.
- Best-in-class enterprises establish, constantly monitor, and work to improve systems that continually update foreign supply market information and make it accessible to decision-makers.
- Supply management and procurement at these enterprises is structured in a center-led, locally executed structure with cross-functional responsibility for cost control via strategies such as LCCS.
- The experience of best-in-class enterprises demonstrates that LCCS should not be a procurement-driven initiative. Successful LCCS requires cross-functional involvement. Most important, it requires top management's full and active support.
- Best-in-class enterprises adjust their LCCS systems, processes, and strategies as global markets change and evolve, and costs change. Today's low-cost country



may not deliver the same benefits in the future, and BIC enterprises are constantly evaluating all markets and adjusting their LCCS and overall supply management strategies accordingly.

- Best-in-class enterprises are positioned to expand sourcing and procurement automation tools and other technologies to capture full value from LCCS initiatives.

Change Management is Key Part of Alcan's LCCS Expansion Plan

Purchasing at Alcan, a manufacturer of aluminum and packaging products headquartered in Montreal, has been sourcing from low-cost countries for many years. As part of its recently launched procurement transformation process, the company is planning to expand and formalize the program to gain full value from LCCS, and has launched an internal change management process to accelerate the expansion effort.

LCCS is "part of our corporate-wide procurement transformation program," says Greg Courts, director of strategic sourcing in Alcan's Primary Metal Group. The procurement transformation with Alcan Global is being led by Alcan's corporate vice president of procurement, Jacques Barrailler.

"The LCCS initiative involves a number of critical steps, the first being to establish a "fact base," such as identifying our current spend in LCCS and then identifying opportunities to further increase our competitive advantage by sourcing through low-cost countries," Courts says.

Marc Gratton, vice president of procurement for the Primary Metal Group, is heading the effort. Alcan is forming a cross-business procurement team with a procurement professional from each of the company's four business groups. Once the fact base is established and a category opportunity analysis has been identified, the team will present the case for change to Alcan's senior management group.

Courts reports that Alcan, through its Primary Metal Group, is leveraging Ariba's knowledge and expertise in LCCS to examine the spend database, identify possible spend categories, and then validate whether these categories are suitable for LCCS. Alcan is also interviewing buyers to leverage their category expertise. "We're also trying to leverage our plants and offices in low-cost countries to support this whole process from a market-intelligence perspective," Courts says. This, coupled with external benchmarking, allows the case for change to be built.

"It's all about building the platform so we can present to Alcan management the size of the prize and how to get there," Courts explains. "We're looking at various options, including setting up IPOs, outsourcing to a third party, and using Alcan's network of resources." Alcan will develop a low-cost supply market intelligence network or publication to keep its people aware of "what's happening in these emerging markets."

Procurement at Alcan believes that, on average, it can achieve total landed cost savings of about 30%, over two to three years. "Some things will take time," Courts says. "We can't just change specifications and change suppliers overnight." However, he adds there are some "quick hits" the company can achieve in the first year for non-complex spend categories.



Change Management is Key Part of Alcan's LCCS Expansion Plan

Taking steps to manage LCCS risks is part of each individual spend category plan. "Ariba has been helpful in this area as well," reports Courts, who adds that Alcan must address several questions: "Do we carry extra inventory, and what is the impact of that? Before we buy a product from a low-cost country supplier, we need to understand how to manage the risk."

Courts identifies social responsibility as one LCCS challenge. "Arbitrarily moving to a source in China has a negative impact on the community from which our current supplier resides. We have to target the right commodities and work with local communities," he explains.

To achieve buy-in from each business unit, Alcan management plans to set a target goal of sourcing a specific percentage of procured goods from low-cost country sources. "We are building our business case, business unit by business unit," he says.

Another challenge to Alcan's LCCS expansion is very common: Getting remotely located procurement people to agree to switch to low-cost country suppliers. "Our procurement people in various regions of the world have to service their customers. LCCS is a big change for these buyers. Their tendency when lead times are short is to go to the local supplier they're very familiar with. Education and change management will be major challenges."

To accelerate the change management process, a survey was sent to 1,200 Alcan employees about the company's intention to expand LCCS. Four hundred have responded. "The survey is one of the best things we've done," Courts says. "It's been an excellent way to make Alcan employees aware of what we plan for LCCS, while making sure we have a clear understanding of the internal challenges we will face."



The LCCS Decision-Making Process

Aberdeen has developed the framework in Table 4 to help enterprises evaluate the various factors that influence a company's decision to use LCCS to procure specific goods from a specific low-cost market. A "high" rating means that specific factor tilts the decision-making process toward either domestic sourcing or LCCS. This framework can be used to evaluate the viability of sourcing any spend category from any low-cost country. If LCCS viability is established an in-depth evaluation process should be started.

Table 4: LCCS Decision Framework

		Domestic Sourcing	Factors		LCCS
Attributes	Supply Market	Select ✓	High (▲) and low (▼) indicators describe how various supply market and product attributes influence whether a product or service is best sourced domestically or via LCCS.		Select ✓
		▼	Labor Content	▲	
		▼	Strategic Importance of Market	▲	
		▼	Supplier Capability	▲	
		▲	Shipping/Logistics Cost	▼	
		▲	Security Risk	▼	
		▼	Political Stability	▲	
		▲	Cultural and Language Barriers	▼	
	Product	▼	Labor Content	▲	
		▲	IP Content	▼	
		▲	Importance of Lead Time	▼	
		▼	Level of Product Specialization	▲	
		▲	Product Complexity	▼	
		▲	Service Requirements	▼	
		Total:			Total:

Source: AberdeenGroup, June 2005



Chapter Four: Recommendations for Action

Key Takeaways

- Consider how an effective LCCS initiative can help the enterprise achieve its short- and long-term business goals.
- To identify LCCS opportunities, use internal, cross-functional expertise and foreign supply market knowledge, or engage third-party foreign supply market experts.
- Take sufficient time to plan LCCS launch or execution, considering all factors that affect total landed costs.
- Create systems and processes that can be used to monitor and analyze foreign supply markets; use the gathered data and intelligence to maximize value obtained via LCCS.

Based on research results, Aberdeen recommends that enterprises take the following steps, based on their level of maturity with LCCS:

Laggard: Steps to Success

1. *Examine overall business objectives, including expansion goals in foreign markets, and assess the opportunity for using LCCS to help achieve those objectives.*
2. *Assess total enterprise spend to determine what spend categories can be sourced offshore.* Investigate possible benefits that could be gained through sourcing from suppliers in low-cost countries, starting with the most strategic spend categories. Hire outside help from third-party experts (consultants, LCCS service providers) to examine LCCS opportunities and formulate an LCCS strategy.
3. *Get unqualified support from top management.* Without it, the program will fail.
4. *Form an LCCS strategy.* Keep in mind that you may need additional outside resources to develop and execute it. Ensure the strategy is aligned with overall business strategy and there is adequate funding to acquire needed resources or foreign supply market intelligence.
5. *Execute the LCCS strategy.* Bear in mind that LCCS steps typically take longer – sometimes significantly longer – than domestic sourcing steps.
6. *Closely monitor LCCS results.* Change the strategy and tactics as needed, and expand the program as LCCS knowledge grows and business processes improve.

Industry Norm: Steps to Success

1. *Examine the current LCCS program and consider expanding it.* As Aberdeen's research results prove, enterprises that source more than one-fifth of their total spend enjoy a much higher level of cost savings. As foreign supply markets mature, leading suppliers' capabilities rise quickly, and sourcing of new spend categories may be feasible. Include custom manufacturing services in the spend categories that are examined.



2. *Establish business processes and investigate service and technology solutions that can better track changes in foreign supply markets*, including pricing, compliance requirements, tariffs, taxes, and other factors that affect total landed cost. An enterprise that can react quickly and decisively to market changes can gain a competitive edge.
3. *Determine if resources should be shifted to, or established in, low-cost countries to develop supplier capabilities*. Best-in-class enterprises often invest key resources in low-cost countries to develop strategic suppliers because benefits can be significant.
4. *Examine skill sets to determine if new or more advanced skill sets are needed for continuous development of foreign suppliers*. Supply managers who deal with low-cost suppliers need a variety of people skills and other management skills that are far removed from the skills needed to process transactions or even develop suppliers in high-cost countries/regions.
5. *Conduct total landed cost evaluations of all aspects of acquiring and transporting goods acquired via LCCS*. Leverage tariff and trade intelligence, and total cost modeling technology where appropriate. Be aware that switching costs are significantly higher when dealing with foreign suppliers compared with domestic suppliers.

Best in Class: Next Steps

1. *Monitor and improve information systems that will provide accurate, rapid visibility into foreign supply markets*. Agility will become a key differentiator in LCCS, so BIC enterprises are working to improve the accuracy and speed of delivery of systems and processes that provide that visibility.
2. *Examine all aspects of LCCS supply chains, identify weak links, and perform cost/benefit analyses of developing low-cost suppliers*. BIC enterprises carefully target strategic low-cost country suppliers for development, and they make the necessary investment to ensure development efforts succeed.
3. *Take steps to optimize total landed cost and delivery strategies that balance total cost, performance, and risk/benefit tradeoffs to create the most tax-efficient supply chain*.
4. *Frequently do make-versus-buy analyses of products sourced via LCCS. Examine contract manufacturing and outsourcing as alternatives to manufacturing*.
5. *Frequently review LCCS strategy and adjust accordingly*. Shift supply allocation and sourcing strategies based on demand and landed-costs optimization. Equally important, have a strategy to exit low-cost countries amid negative market shifts.
6. *Investigate opportunities to utilize sourcing, procurement, and supply chain technologies to drive additional efficiencies and performance improvements into existing LCCS supplier relationships*.



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Kevin R. Fitzgerald is vice president of supply management research for Aberdeen. Fitzgerald conducts research on the use of technology to automate various supply management activities, including strategic e-sourcing, supply optimization, supply base management, supplier measurement and development, global sourcing, category spend management, outsourcing of procurement, low-cost country sourcing, and other areas of compelling interest to top-level procurement professionals and supply management executives.

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Tim Minahan is senior vice president of supply chain management research for Aberdeen. In this role, Minahan provides analysis and assessment of software and services that automate and streamline procurement, sourcing, design, and supply chain management operations.

Minahan specifically focuses on total cost management (TCM), which is an organizational and technological framework for managing the total cost of ownership of supply relationships. Within TCM, Minahan tracks spending analysis, sourcing, procurement execution, contract management, and supplier performance measurement technologies. Minahan also covers product life cycle management (PLM) technologies and their convergence with TCM. Minahan continually consults with early implementers of these applications to identify world-class supply management strategies and to determine the strengths and weaknesses of technology solutions and services that are competing in this market.

His current research efforts include Aberdeen's quarterly E-sourcing Index (ESI), as well as benchmark studies on procurement outsourcing, "the wireless supply chain," and supply management practices in the public sector.



Appendix A: Research Methodology

Between April and June 2005, **AberdeenGroup** collected data and examined the low-cost country sourcing programs and plans of more than 170 enterprises across a broad range of manufacturing and service industries, including automotive manufacturing, high-technology manufacturing and services, industrial equipment and machinery, chemical and other process industries, utilities, and retail enterprises.

Responding companies were asked details about their LCCS programs, including:

- Criteria used to access an LCCS opportunity;
- Creation of international purchasing offices (IPOs) to facilitate sourcing;
- Use of third-party sources for knowledge and analyses of foreign supplies and foreign supply markets;
- Foreign markets that were used for LCCS;
- Spend categories that are most popular in LCCS programs;
- Management and organizational factors that enhance or inhibit LCCS efforts;
- Functional responsibility for LCCS;
- Benefits received via LCCS; and
- Methods used to mitigate LCCS risk.

Some details about the responding companies:

- **Job title/function:** The research sample included respondents with the following job titles: procurement, supply chain, logistics executive or manager, manufacturing/operations executive or manager, CFO or other C-level officer.
- **Industry:** The sample included respondents from across nearly all manufacturing and many service industries. Manufacturers of high-technology products represented 15% of the sample; automotive manufacturers represented 8%. Every other industry represented less than 8% of the total sample.
- **Geography:** Nearly half (48%) of the respondents were from the U.S., with another 2% from Canada. Others were from Western Europe (28%), Asia (14%), South America (3%), Eastern Europe (3%), and Africa (3%).
- **Company size:** Nearly one-third (32%) were from large enterprises (annual revenues of more than \$1 billion); 37% were from mid-size enterprises (between \$50 million and \$1 billion); and 31% were from small businesses (up to \$50 million).

Solution providers recognized as sponsors of this report were solicited after the fact and had no substantive influence on the report's direction. Their sponsorship has made it possible for **AberdeenGroup** to make these findings available to readers at no charge.



Table 5: PACE Framework

PACE Key
Aberdeen applies a methodology to benchmark research that evaluates the business pressures, actions, capabilities, and enablers (PACE) that indicate corporate behavior in specific business processes. These terms are defined as follows: <i>Pressures</i> — external forces that impact an organization’s market position, competitiveness, or business operations (e.g., economic, political and regulatory, technology, changing customer preferences, competitive) <i>Actions</i> — the strategic approaches that an organization takes in response to industry pressures (e.g., align the corporate business model to leverage industry opportunities, such as product/service strategy, target markets, financial strategy, go-to-market, and sales strategy) <i>Capabilities</i> — the business process competencies required to execute corporate strategy (e.g., skilled people, brand, market positioning, viable products/services, ecosystem partners, financing) <i>Enablers</i> — the key functionality of technology solutions required to support the organization’s enabling business practices (e.g., development platform, applications, network connectivity, user interface, training and support, partner interfaces, data cleansing, and management)

Source: [AberdeenGroup](#), June 2005

Table 6: Relationship between PACE and Competitive Framework

PACE and Competitive Framework: How They Interact
Aberdeen research indicates that companies that identify the most impactful pressures and take the most transformational and effective actions are most likely to achieve superior performance. The level of competitive performance that a company achieves is strongly determined by the PACE choices that they make and how well they execute.

Source: [AberdeenGroup](#), June 2005



Appendix B: **Related Aberdeen Research & Tools**

Related Aberdeen research that forms companion or reference works to this report include:

- *The CPO's Agenda* (March 2005)
- *New Strategies for Global Trade Management* (March 2005)
- *The Global Sourcing Benchmark Report* (June 2003)

Information on these and any other Aberdeen publications can be found at www.Aberdeen.com.



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