SOURCING STRATEGIES & GLOBAL SOURCING

1. Introduction

Strategic sourcing does not go without saying - instead, it was a long process during the last 30 years in the professional field of purchasing to reach strategic importance at top management level.

<table>
<thead>
<tr>
<th>The way towards strategic sourcing: A literature review</th>
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<tbody>
<tr>
<td>• “The progression from purchasing to supply management involves two major paradigm shifts: (1) from a focus on internal processes to value-adding benefits and (2) from a tactical to a strategic focus. [...] Many of the manual tasks presently performed by purchasing will be automated or reassigned so that the personnel in supply management will be concerned with producing high value added, not paperwork. [...] They truly will become managers of the organisation's outside production!” DOBLER/BURT 1996</td>
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<tr>
<td>• “The 1980s marked the beginning of a shift in attitudes towards purchasing’s role in corporate strategy. In the 1970s and early 1980s, purchasing took a supportive role, ensuring that supplier quality met the required standards for production. During the 1990s, the literature indicates a movement toward integrating purchasing into the firm’s strategic planning process. Today purchasing’s ability to impact strategic planning has increased in a number of firms.” CARR/SMELTZER 1997</td>
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<tr>
<td>• “It is anticipated that recent and continuing developments in sourcing and supply management will play a critical role in the restructuring and restoration of many industries as they attempt to attain global prominence. The idea of a domestic market and economy has been superseded by the more practical view that all markets and economies are a part of the global economic picture in which all industries must compete.” CARTER/NARASIMHAN 1996</td>
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</table>

Especially the last quotation shows the connection between strategic orientation and globalisation of purchasing activities. Nowadays, purchasing has to deal with more and more international supply markets - either because national suppliers are just not available (e.g. concentration of semiconductor industry in Asia and USA) or national suppliers are not competitive.

In this module, you will learn

- to understand idea and concept of global sourcing,
- to formulate a global sourcing strategy,
- to integrate global sourcing in an overall sourcing strategy,
- to establish structural alternatives for realising global sourcing.

You will not learn operative details of the global environment like trade regulations, international logistics or legal frameworks because this will be part of Modules B1 to B9.
To lead you through this information, we will present to you a learning guideline, which structures all information and will arise at the beginning of every chapter.

2. Global sourcing and sourcing strategies

To learn on global sourcing, we will develop (1) a common global sourcing understanding, (2) elements of a global sourcing strategy, and (3) global sourcing structure patterns. All three elements together form the *global sourcing pyramid*.

The levels of the pyramid must fit together perfectly - otherwise global sourcing will not work. This means (a) according to CHANDLER (1962) hypothesis a structure-strategy-fit and (b) an understanding-strategy-fit (VENKATRAMAN/CAMILLUS 1984). Companies can develop a suitable global sourcing strategy only if they are able to understand global sourcing in all its dimensions and with all its chances and risks. On the other hand, a global sourcing strategy must be executed by a suitable organisation.

Within their empirical evaluation of future trends in purchasing CARTER/NARASIMHAN (1996) found that global sourcing is ranked 23rd out of 36 trends by North American and European purchasing executives. Obviously, the decision to source globally seems to be a kind of ‘common sense’. But the question how to realise these strategic objectives and how to organise global sourcing effectively is still not answered.

3. Global sourcing understanding

Level 1 of the global sourcing pyramid has a closer look on the *understanding* of global sourcing. Therefore, we will develop a global sourcing definition which deals with *globalisation* as a major economic trend. Reasons for globalisation are overcapacities in highly industrialised countries, significant disadvantages in respect to labour costs, emergence of worldwide information networks to connect information systems of firms, and the emergence of larger ‘domestic’ market areas like NAFTA, MERCOSUL (South America), or the Common Market in Europe.

The term ‘global sourcing’ is used by nearly every purchasing professional - irrespective of their position in practice or academia. A closer look on some
definitions shows that this does not necessarily mean everybody is really talking about the same thing:

<table>
<thead>
<tr>
<th>Definitions of “global sourcing”</th>
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<tbody>
<tr>
<td>• “Global purchasing” is just “offshore buying” HICKMAN/HICKMAN 1992</td>
</tr>
<tr>
<td>• “In recent years, the term ‘foreign sourcing’ has largely been replaced with ‘international sourcing’: the process of purchasing from suppliers outside the firm’s country of manufacture.” DOBLER/BURT 1996</td>
</tr>
<tr>
<td>• Global sourcing is “the integration and co-ordination of requirements across worldwide business units, looking at common items, processes, technologies, and suppliers.” MONCZKA/TRENT 1991</td>
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<tr>
<td>• LEENDERS/FEARON (1997) define global sourcing as a major strategic component: &quot;Over the past decade, the activity in international purchasing has increased substantially, due primarily to two considerations: the increased design, production, and distribution capabilities of foreign suppliers; and the pressures for cost reduction in the manufacturing process.”</td>
</tr>
</tbody>
</table>

According to the last quotation of LEENDERS/FEARON (1997), procurement must define global sourcing as a strategic alternative to benefit from the advantages of internationalisation. International purchasing has to be developed into global sourcing by using a strategic focus. This means: realising competitive advantage. In fact, globalisation refers to two aspects (ARNOLD 1989):

1. Operating in international marketplaces: Here, globalisation means systematically extending procurement policy towards sources in foreign markets at least worldwide.

2. Strategic orientation: Here, globalisation means an overall orientation of purchasing activities in order to secure the profit base of a firm.
The figure combines these two dimensions and creates four sectors of purchasing activities: Besides traditional procurement and a just operative-oriented ‘going international’ there is the field of strategic supply management and the field of global sourcing which integrates high degrees in both aspects of globalisation.

The importance of global sourcing in the future can be demonstrated by some figures on German companies out of an international study conducted by the CENTRE FOR ADVANCED PURCHASING STUDIES (CAPS). According to that an average of 34% of the purchasing volume is bought internationally today. But 89% of the respondents assume this number will increase. Especially purchasing from Asia (83% of respondents expect an increase) and Eastern Europe (70% of respondents expect an increase) will grow dramatically (ARNOLD ET AL. 1999).

4. Global sourcing strategy

At Level 2 of the global sourcing pyramid, we will have a closer look on global sourcing strategy. A strategy is defined as “an action plan designed to permit the achievement of selected goals and objectives” (LEENDERS/FEARON 1997). Based on that, supply management has to develop its own strategic plan according to the general strategy of the whole company. Global sourcing is only one part of supply strategy - but it is an important one. Because strategic plans focus on the achievement of long-term goals, all parts of a strategy have to fit together perfectly. In the following case study, we show how a leading chemical company integrates purchasing in the strategic planning process.

Strategic planning in purchasing: Case study BASF

Besides Bayer and Hoechst, BASF is one of the three big German manufacturers of chemistry with a wide range of industrial and consumer products. The product range covers the entire spectrum of chemical products: health/food, colorants/upgrading products, basic chemicals, synthetics/fibres, and oil/gas.

The raw materials purchasing department is a globally acting unit performing the buying task for BASF AG, Germany, and coordinating the purchasing processes for the entire group. It is managed as a corporate division exclusively subordinate to the executive board.

On principal, the strategic planning process of raw materials purchasing can be characterised by a top-down orientation dominated by the corporate, sales and production planning. Since the raw materials markets are very volatile and not to forecast sufficiently the planning activities are focusing on the short-term planning. The field of long-range planning can be described more as a vision rather than a pure strategic planning process. The operational planning comprises the budget planning for one year and a mid-range planning for three years. Both plans are revised once per year (in fall). Within these operational planning activities, raw materials purchasing is projecting the development for 50% of the sourced products that mean 80% of the purchased US$-volume.

In the corporate planning process, raw materials purchasing acts as an information provider delivering prices for the other departments. In a first step, raw materials purchasing receives the expected sales and production quantities that are the base for the operational purchasing plans. All planning data in this planning process related to quantities and prices. The amount of prices and quantities forecast for the upcoming planning period are mirrored in the purchasing budget which has to be understood as the central benchmark.
for the purchasing performance. In total, more than 15 value adding functions of the entire corporation are involved in the planning system relying on the information and expectations of raw materials purchasing. Every buyer is partly responsible for the purchasing planning forwarding its/his data into the planning system. Frequently, these planning activities are supported by close consultations between raw materials purchasing and its customers. These discussions become more and more necessary when raw materials purchasing expects very volatile price developments within the next planning period. The main objective of this consultation is to receive reasonable data for all partners (internal customers) to establish realistic budgets and performance targets. The result of the planning activities are fixed prices for the raw materials that are valid/guaranteed for the internal customer over the entire planning period. During the realisation phase raw materials purchasing has to concentrate its activities to reach the planned result on the base of the promised prices.

Raw materials purchasing is recognised as a corporate function with high reputation and a widespread strategic character. Important parts of the strategic plans of the entire BASF group are lead by the Vision 2010. In the development and realisation process of that vision raw materials purchasing plays one of the key roles regarding the risks and chances of a raw materials market in change. For purchasing, this vision is directed to assure the highest degree of supply security linked with lowest possible prices.

The case study shows the importance of a well formulated supply strategy. Without that, purchasing would never be regarded as a centre of excellence with best supply know how. One of the most important instruments in the strategic planning process is portfolio technique. Portfolios help to formulate an adequate strategy. For defining the right global sourcing strategy, purchasing has to analyse

(a) the goods and services to be sourced:

Therefore, the object portfolio distinguishes four types of goods depending on their specificity and their strategic importance. Strategic importance refers to the contribution of the good or service sourced to the competitive advantage of the company on its sales markets. Specificity refers to the degree of individuality of the object - highly specific goods are produced for one customer only.

As a result, there is a range of goods from uncritical products with low specificity and low strategic importance to customer-tailored focus products with both high importance and specificity. In between, there are strategic and individual products as shown in the object portfolio below.
(b) the *markets* where to be sourced.

While the object portfolio is primarily internal oriented, the *market portfolio* has a closer look on the external market situation. The buying market situation is described best by looking on suppliers and their capabilities. As a result, the market portfolio has two dimensions: The number of domestic suppliers and the technological advantages of foreign suppliers. Often, companies are forced to source internationally due to the fact that some high-tech products are just not available from domestic suppliers, e.g. microelectronics/semiconductors. As a result, we distinguish between the know-how based global sourcing-situation, where buyers make use of the technological advantage of foreign suppliers, and the market-based global sourcing-situation, where buyers just look for international supplying alternatives. The worst situation from a buyer’s point of view is called ‘critical global sourcing-situation’. In this case, the number of domestic suppliers is low and the technological advantage of foreign suppliers is high.

The four product types and the four market situations can be brought together in the so-called ‘global sourcing strategy type portfolio’. This portfolio identifies three major types of *global sourcing strategies*:

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*Strategic products* and *Customer-tailored focus products* have high strategic importance and low specificity, making them the most important to source strategically.

*Uncritical products* and *Individual products* have low strategic importance and high specificity, making them less critical and more easily sourced.

The diagram shows how the different product types and market situations align:

- **High Technological Advantages of Foreign Suppliers**
  - **High Number of Domestic Suppliers**: *Know-how-based global sourcing situation*
  - **Low Number of Domestic Suppliers**: *Critical global sourcing situation*

- **Low Technological Advantages of Foreign Suppliers**
  - **High Number of Domestic Suppliers**: *Uncritical global sourcing situation*
  - **Low Number of Domestic Suppliers**: *Market-based global sourcing situation*
Technology-oriented global sourcing is a strategy which is closely connected with high-tech sourcing outside domestic markets. The following case study (Sony Electronics Europe) shows that companies are often forced to buy abroad because there is just no domestic alternative.

Technology-oriented global sourcing; Case study Sony Electronics Europe

Sony is an international electronics corporation. Originally based in Japan, the company holds subsidiaries and production activities in all major regions of the world. It is structured into ten divisional operation companies (e.g. Video, TV, Audio, Mobile Electronics etc.). In Europe, Sonys total sales volume was about 3.5 Bil. US$ and the purchasing volume was about 1.5 Bil. US$.

Sonys general procurement strategy is to source locally. This means, that Sony prefers to source everywhere the company manufactures. “Sony promotes local procurement of excellent parts in each of its manufacturing plant locations. Locally produced parts, as long as they satisfy QCDS (Quality, Cost, Delivery, and Service), will be most competitive. Moreover, local procurement is ideal in terms of establishing close, co-operative ties between Sony and its suppliers.” (SONY 1994)

But being an electronics company, Sony relies heavily on parts like passive elements. It is nearly impossible for Sony Europe to source these parts in Europe - they have to source them internationally.
### Items Globally purchased

<table>
<thead>
<tr>
<th>Items</th>
<th>Globally purchased</th>
</tr>
</thead>
</table>
| Mechanical parts                           | ~ 0%               
| Electromechanical parts (e.g. plugs)       | ~ 50%              
| Active elements (e.g. integrated circuits) | ~ 65%              
| Passive elements (e.g. resistors)          | ~ 85%              

The table above shows that local sourcing works good for mechanical parts, but active and passive elements have to be bought by a technology-oriented global sourcing strategy.

- **Cost-oriented global sourcing** is the strategy pattern that helps to increase competition. As its name says, the major goal is not to get one step ahead in technology but to save cost. It is useful for standardised products where suppliers are easily available in domestic and international markets.

- **Competition-oriented global sourcing** differs from cost-oriented global sourcing not in the goal to reinforce competition - but it does not have a single cost reduction focus. Instead, it tries to gain new product ideas and developments in uncritical market situations by addressing foreign suppliers (type 1) or it looks for a wider range of supply markets and suppliers for less critical products (type 2).

These three strategy patterns for global sourcing show the direction in which global sourcing goes regularly. Supply management has to observe the dimensions of the pre-portfolios mentioned above carefully before they can formulate an adequate global sourcing strategy.

Sometimes, the reason for going internationally in purchasing differs from the three strategies mentioned above. The following case study shows an example of a mainly sales-driven global sourcing which led in the end to cost-oriented global sourcing.

#### European automobile export to non-EC countries: Case study

Most well established European automotive manufacturers are confronted with compensation requirements when exporting their products outside the EC. Some years ago a large automobile manufacturer in France had to arrange for counter purchases in a certain non-EC country for at least 25% of its local sales. Part of the requirements were settled through the purchase of steering wheels, synthetic doors and rubbers. This, however, was not enough. A program for purchasing market research was organised and carried out. First, on basis of industry statistics it was analysed which purchasing goods possibly could be acquired from that specific country. Then, possibly interesting industries and companies were mapped out, based on interviews with embassy representatives. After this, a small delegation of buyers and quality experts visited the most interesting suppliers in that country. They found producers of springs and a number of well-
equipped fine-mechanic firms, which had the basic capacity to produce crankshafts. Production and quality engineers were being sent to these potential suppliers to familiarise them with mass production and modern quality control-techniques. After this investment in knowledge transfer, the car manufacturer made an investment in production machines. Nowadays, this manufacturer acquires an important part of his springs and more than half of his crankshafts from this specific country at competitive prices, whereas the sales’ market share has been sustained - in spite of Japanese competition.

Source: VAN WEELE 1998

Global sourcing alone is not a total supply strategy - but it is an important part of it. The following 'sourcing toolbox' gives an overview about the sub-strategies, which form together an integrated sourcing strategy.

<table>
<thead>
<tr>
<th>Supplier</th>
<th>single</th>
<th>dual</th>
<th>multiple</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchasing object</td>
<td>unit</td>
<td>modular</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchasing area</td>
<td>local</td>
<td>domestic</td>
<td>global</td>
<td></td>
</tr>
<tr>
<td>Purchasing time</td>
<td>stock</td>
<td>just-in-time</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchasing subject</td>
<td>individual</td>
<td>co-operative</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Place where value added</td>
<td>external</td>
<td>internal</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- example for a sourcing concept combination

We see global sourcing as an alternative to local and domestic sourcing in the area sub-strategy. On the other hand, supply management has to decide (a) the number of suppliers (one, two, or more than two leads to single, dual, or multiple sourcing), (b) the kind of object to buy (simple parts or complex modules leads to unit or modular sourcing), (c) the time when to deliver (long-term delivery on stock sourcing or just-in-time), (d) the number of buyers to buy with (only one or as a purchasing consortium leads to individual or co-operative sourcing), and (e) the place where to add value by suppliers (on their own supplier plant or in the plant of the buyer leads to external or internal sourcing). Global sourcing has to be combined with one sourcing concept from every other sub-strategy as shown in the toolbox above for example. We will describe this toolbox as an example how to make use of transaction cost economics in Module C1 of the Eurodiploma.

5. Global sourcing structure

On level 3 of the global sourcing pyramid we will have a closer look on the global sourcing structure. This chapter will answer the questions how to realise the strategies developed above effectively and how to organise global sourcing.

Organisational problems are dominated by the question of the degree of centralisation. Like ebb and flow, the pendulum of centralisation swings periodically towards the option full centralisation or full decentralisation. Modern management concepts like lean management, business reengineering, and virtual enterprise are closely related with the recommendation of more decentralisation. A structural shift appears: A firm changes from a static inflexible hierarchy to a flexible network of more or less independent business units. Profit centres are the preferred organisational unit and general management evolves to a management of the business unit portfolio. In terms of global sourcing, (de-) centralisation is the variation of
purchasing elements (departments, procurement processes, and responsibilities) within the global sourcing system. In general: If there is no accumulation of these elements, the degree of centralisation is low.

With regard to global sourcing, decentralisation is a chance and a risk as well: It is a risk because the purchasing departments of business units might be too small to purchase globally and in an efficient way. Strategic orientation of all procurement activities may be neglected. On the other hand, decentralisation is a chance because it makes it easier to cross borders and to establish business units with procurement functions in foreign countries. Decentralisation can stimulate internal competition between business units. In other words: The spirit of entrepreneurship is a great advantage but the disadvantages of small and medium sized companies (especially lower scale effects) are disadvantages of the profit centre system too. MATTHYSSENS/FAES summarised the following arguments in favour of decentralised and centralised purchasing:

<table>
<thead>
<tr>
<th>Arguments in favour of decentralisation</th>
<th>Arguments in favour of centralisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Local management responsible for all costs including purchasing might become frustrated if they lose control over such an important cost item.</td>
<td>1. Stronger negotiating positions versus suppliers, hence better prices and terms.</td>
</tr>
<tr>
<td>2. Close co-operation between local buyers and users. Good fit with local requirements.</td>
<td>2. Construction of a group purchasing and procurement strategy. Uniformity leads to economies of scale.</td>
</tr>
<tr>
<td>3. Choice of local suppliers: - better and faster service; - shorter delivery times; - sometimes better terms; - goodwill to local community.</td>
<td>3. Acquisition of better, more profound knowledge of the market. Establishment of a global supply view.</td>
</tr>
<tr>
<td>4. Local buyers more motivated.</td>
<td>4. Efficient use of available purchasing skills.</td>
</tr>
<tr>
<td></td>
<td>5. Less administrative work and reduction of purchasing organisation expenses.</td>
</tr>
</tbody>
</table>

Keeping these arguments in mind, we can distinguish three possible structure models for global sourcing (ARNOLD 1999):

First, global sourcing can be organised fully centralised. All domestic and international purchasing activities are done by the central purchasing department in the home country. As a result, the negotiation power is used in an optimal way concerning scale effects.

On the other hand, the purchasing organisation is far away from the supply markets. Without regional know how, especially in cultural skills, it might not be easy to source successful in foreign markets.
Second, global sourcing structure can be fully *decentralised*. Foreign subsidiaries of the company (e.g. manufacturing or sales subsidiaries) are responsible for the supply market they are working in as well. All international sourcing is done by foreign-based organisation.

Now, the company is able to use the regional skills of the workforce - language or culture problems may be avoided. Instead, the problems of decentralisation as mentioned in the table above arise.

The third structural alternative is another kind of decentralisation. Global sourcing activities are done by *international purchasing offices (IPO)*. These IPOs are located in foreign markets but separated from the general organisation. They are headed by the domestic central purchasing department but have to operate with full responsibility for the supply markets in the region they are in.

The IPO concept allows combining the advantages of centralised and decentralised purchasing.

The decision about the best structural alternative for global sourcing heavily depends on individual factors of the company and the markets they act in. In general, a major factor is cost. *Direct procurement cost per unit* decrease with a higher degree of centralisation in global sourcing because of economies of scale, economies of process, and economies of information. At the same time, *co-ordination cost* arises.
It looks like the decentralised IPO structure is advantageous. But empirical results do not go confirm with that. According to a recent CAPS study, the centralised structure dominates. The following table shows the results in detail:

<table>
<thead>
<tr>
<th>Structure model #1: centralised global sourcing</th>
<th>Structure model #2: decentralised global sourcing</th>
<th>Structure model #3: decentralised IPO global sourcing</th>
<th>Some mix of centralised and decentralised</th>
<th>Other global sourcing structures</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>48%</td>
<td>23%</td>
<td>6%</td>
<td>49%</td>
</tr>
<tr>
<td>Germany</td>
<td>58%</td>
<td>14%</td>
<td>7%</td>
<td>33%</td>
</tr>
<tr>
<td>U.K.</td>
<td>16%</td>
<td>10%</td>
<td>6%</td>
<td>14%</td>
</tr>
<tr>
<td>Belgium</td>
<td>43%</td>
<td>23%</td>
<td>0%</td>
<td>64%</td>
</tr>
<tr>
<td>Canada</td>
<td>32%</td>
<td>11%</td>
<td>3%</td>
<td>35%</td>
</tr>
<tr>
<td>France</td>
<td>75%</td>
<td>14%</td>
<td>0%</td>
<td>11%</td>
</tr>
<tr>
<td>Hungary</td>
<td>64%</td>
<td>9%</td>
<td>20%</td>
<td>18%</td>
</tr>
<tr>
<td>All countries</td>
<td>48%</td>
<td>16%</td>
<td>6%</td>
<td>32%</td>
</tr>
</tbody>
</table>

6. Conclusions

This module gave an overview on basic concepts of global sourcing and sourcing strategies. Leenders/Fearon (1997) describes the necessity of a strategic orientation in supply management as follows: “Today, firms face the challenge of maintaining or regaining position in world competitive markets. The ability to relate effectively to outside environments - (1) social, (2) economic, (3) political and legal, and (4) technological (with its changing materials and processes) - to anticipate changes, to adjust to changes, and to capitalise on opportunity by formulating and executing strategic plans, is a major factor in generating future earnings and is critical to survival. Supply now must be forward looking - it no longer is adequate simply to react to the current situation and problems.”

According to that statement, this module

- helped to understand the global sourcing concept in general,
• developed a global sourcing portfolio to formulate adequate global sourcing strategies,
• showed how global sourcing has to be combined with other sourcing concepts to an integrated supply strategy,
• described ways to execute global sourcing by suitable structural patterns.
7. Directions for further study

Text books:

Other books and reports:
- SONY (1994), Sony Procurement Guidelines, Kanagawa.

Articles:
Self-assessment questions:

1. What does global sourcing mean? To what extent does it refer to globalisation? Why is global sourcing not equal to international procurement?
2. Which factors influence the global sourcing strategy? Define different global sourcing strategy patterns in respect to these factors.
3. Why do companies source globally? Which are the major reasons for expanding sourcing activities?
4. Which arguments stand in favour of (a) centralisation and (b) decentralisation of global sourcing activities?
5. Why is it necessary to integrate purchasing into the company’s strategic planning process? Which elements form a sourcing strategy?
6. Which general alternatives exist for organising global sourcing? Describe the advantages and disadvantages of these alternatives. Can you give a recommendation?