



**Survey 2008 - Key trends in global sourcing in Vietnam**

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**INTERVIEW**



**Renato Teodoro Goebel**

Renato Goebel is the Chief Procurement Officer of Votorantim International in China. With deep experience developed over more than 12 years in industry both in multinational corporations such as Unilever and in Brazilian local giants, he was responsible for setting up the China IPO for Votorantim and for managing its daily operations.

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**ARTICLE**



**Sourcing in China: Three Issues That Keep Purchasing Managers Awake at Night**

Everyone in the sourcing field who has been in China for a while is well aware of the challenges companies are currently facing. Being one of the most fast-changing and dynamic countries in the world,

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**NEWS AND TRENDS**

**Half Of Chinese Toy Exporters Close Down**

China's toy industry is undergoing a major change, with more than half of all exporters being forced to close down this year, the General Administration of Customs said in a new report. The report cites the rising RMB, escalating production and labour costs, trade protectionism and falling export rebates as key influences. Small toy producers, with sales of USD100,000 or less, are being hit the hardest, and make up most of the closures.

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**Tesco, Australia, New Zealand Recall Chinese Candies**

China's popular White Rabbit Creamy Candies are being withdrawn from Tesco supermarket stores worldwide as fears grow that it may contain contaminated milk. The Tesco recall is also in place in Shanghai and Hainan, and is believed to be the first widely known melamine-related recall in China of goods other

than milk products and milk.

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### **VW gears up for massive hike in Indian sourcing**

German car giant Volkswagen AG is to dramatically increase its sourcing levels in India, the company's procurement chief has announced. Speaking at an International Suppliers Fair in Wolfsburg, Germany, Bernd Martin, Volkswagen AG Head of Purchasing (New product Start-Ups), said that the company would look to Indian suppliers for upto €1 billion of its component spend over the next two to three years.

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### **Carlsberg is looking to India to act as its global sourcing hub**

Speaking in Calcutta, Pradeep Gidwani, managing director, Carlsberg and South Asia Breweries India, told reporters that the country was fast developing into one of the Carlsberg's most important strategic locations

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### **Crunch time for Chinese trade fair**

The global uncertainty is taking a heavy toll on business confidence in China, according to buyers at the country's annual import and export fair. The event, which is held in the industrial heartland of Guangzhou, usually attracts procurement chiefs from across the world. However, the Southern Metropolis Daily, the province's biggest newspaper, reported that for every four exhibitors at the start of the fair, there was only one registered buyer – hotel booking have also halved from the levels seen in 2007.

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### **Wal-Mart suppliers to give Uzbekistan cold shoulder**

US grocery giant Wal-Mart has called on its suppliers to stop sourcing cotton from Uzbekistan, as part of a clampdown on child labour practices in the former Russian Republic. Uzbekistan is among the world's most prolific cotton exporters but has come in for increasing criticism in recent months after a series of investigations revealed that child labour was rife in the Central Asian country.

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### **New UN procurement scheme hopes to deliver harvest for the world**

The UN is set to launch a new procurement plan which will revolutionise the way food is purchased and distributed through its World Food Programme (WFP). Under the new 'Purchase for Progress' scheme the UN will buy food directly from some of the world's poorest regions and before redistributing it where it's most needed.

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### **India looks to China for sourcing needs**

Indian SMEs are increasingly viewing China as a major sourcing hub after it was revealed that Chinese exports to the country had grown by over 30 per cent in the past 12 months. Bilateral trade between the two countries currently stands at \$38.5 billion, with some analysts claiming that this figure could grow by over 50 per cent by 2010.

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### **Trade surplus growing but sourcing still looks east**

China's trade surplus has soared to a new record high. While China's trade surplus continues its upward curve, the figures showed the global economic slowdown was dampening the appetite for Chinese goods, with the country's exports down on the levels recorded in September.

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## INTERVIEW

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### Introduction about Votorantim

Votorantim group is one of the largest private business conglomerates in Latin America with 60,000 employees, net revenues of US\$13.3 billion, and EBITDA of US \$3.7 billion. The company exports exceed US\$2 billion.

Acting as a pioneer in group globalization, Votorantim is a conglomerate with highly diversified business activities:

- In the mineral extraction sector, it is one of the world's ten largest cement companies and is the largest integrated aluminum factory in the world. It is one of the top ten producers of Zinc worldwide and the largest producer of Nickel in Latin America.
- It is also the third largest Brazilian producer of non flat steel.
- A Latin America leader in pulp & paper, recognized worldwide in the production of pulp from eucalyptus.
- It operates 31 hydro-electric plants and four thermal electric plants in Brazil.
- Is among the world's top three producers of frozen concentrated orange juice with 20% of the global market
- A world leader in nitrocellulose production.
- The 4th largest private bank in Brazil, with 1.8 million clients, handling the financing of one out of every six cars driving in Brazil

In China, Votorantim officially opened its buying offices in Shanghai in January of 2008. The sales office from Pulp and Paper was opened beginning 2007 and a zinc oxide plant was built at the end 2007 in Changshu, with its sales team also at the same office. A ceremony was later organized in March to introduce the company to major Chinese potential suppliers as a means of overcoming the fact that the company was not well known in China. Votorantim arrived in China with a plan of investing 2 billion USD in China and sourcing close to \$500 million in value over time. However due to the current world economical crisis and turmoil the company decided to postpone this plan.

### Procurement at Votorantim

When stepping into China, Votorantim had two main targets sourcing: a medium to long term target of sourcing \$420 million in spend categories across all Votorantim business areas and an initial short term target of ensuring that procurement savings covered the costs of the buying office; this objective was subsequently enhanced to a target of having to save \$5 million in the first year of operation with a requirement to achieve at least 15% in landed costs on a category per category basis

In order to accomplish these two targets, an initial team of 3 local Chinese sourcing people was built, under Renato's supervision (Renato believes that having Chinese people is essential to the success of the buying office). The team is comprised of a junior Chinese buyer responsible for raw materials, MRO and individual protection equipments, a senior Chinese buyer responsible for machines & other capex plus an executive assistant. Renato indicated that one of his key objectives was to set up this organizational model as rapidly as possible, and then hire more skilled employees as demand grows. In long term, the idea was to prepare the senior Chinese person to take over the lead role in anticipation of his move back to Brazil.

After one year's operation, Votorantim's China sourcing office has fulfilled its mission as \$ 8 million savings have been achieved with the target of \$5 million being reached as early as in the middle of the year 2008. Unfortunately and despite this achievement, the recent worldwide economic crisis has forced the Group to make some painful decisions in order to cut corporate costs and push all sourcing responsibilities back into the 6 Business Divisions. Consequently, the decision was taken to draw back the China sourcing office as well as another IPO in North America. The decision to formally open a third IPO in East Europe has also been cancelled. The China sales office, given that it reports directly back into the Business Divisions, remains in operation

Renato himself strongly believes that no big successful enterprise could take the risk of not addressing China as a key sourcing location. He indicated that Votorantim's actions of drawing back are only temporary and has full confidence that when the crisis is over Votorantim will be back at full steam sourcing aggressively from China. The experience gained over the last year, the relationships established with many Chinese suppliers, the continued presence of the sales office in China will all provide sound foundations from which to re-launch a new China sourcing initiative and build a successful LCC sourcing programme. When comparing Chinese and Brazilian suppliers, Renato believes that they have experimented completely different situation: Chinese industry has gone through a radical transformation over the last 10 years and suppliers have made significant investments in technology and management processes and capabilities enabling them to efficiently conduct business with foreign enterprises. Furthermore the Chinese government has done a superb job at building all the required infrastructure and business support to help Chinese companies develop their brands and compete globally. On the contrary, Brazilian suppliers usually present high productivity, they have had to develop strong "survival" skills in order to grow and strive in an

environment where government provides little support and where the infrastructure is underinvested for the country growth. He also mentioned that in many areas like equipments, raw materials, auto parts and some chemical products China market has a huge potential and should be well explored. When trying to source from China into Brazil, Renato had to face 2 main challenges:

- First, in China where the language is a major barrier and where the way of conducting business is very different from how it is conducted in Brazil. Reaching out to good suppliers and then persuading them to collaborate with their company has often been difficult.
- Second, in Brazil where convincing the local technical and quality people to disregard the comfort of doing business with their well established local suppliers in exchange for the uncertainty associated with sourcing from China has been a difficult change management challenge to overcome.

Despite's Votorantim's decision to temporarily cease its sourcing office in China and to embed all sourcing processes back into the Businesses, Renato is convinced that maintaining a small sourcing presence in China remains of critical importance in order to keep on managing the established supplier relationships and to identify new sourcing opportunities. He estimated that within one year and a half at most the Group will be back to China sourcing actively into the market.

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## ARTICLE

### Sourcing in China: Three Issues That Keep Purchasing Managers Awake at Night

Dr. Martin Lockstrom 罗马汀 博士  
Director Supply Chain Management Institute SMI China

**Everyone in the sourcing field who has been in China for a while is well aware of the challenges companies are currently facing. Being one of the most fast-changing and dynamic countries in the world, China brings numerous challenges to the table, especially for foreign firms with rigid organizations and process-oriented business practices.**

The problem is not change itself – the challenge is to have an agile organization and a supply chain that can cope with it. Thus, the key takeaway is to not overemphasize on planning but instead focus on response, and anticipate surprise. China is the land of surprise, and there is little indication that this fact will change in a near future. One thing is for sure: The winners in the Chinese business landscape are those that thrive on change.

In order to be better prepared for the changes currently taking place, it is of paramount importance to stay up to date with the current trends, to plan, and to take action accordingly. So what are the burning issues that keep purchasing, logistics and supply chain managers awake at night? Generally speaking, the three most important trends one can identify in the Chinese business landscape are (1) price increases, (2) scarcity of qualified human resources, and (3) logistical challenges.

#### Keep Track of Your Wallet

For long being considered a “low-cost country”, China is swiftly moving up the value chain and gradually transforming into a developed country (although rural areas are still lagging behind). But what is really a “low-cost country” and what is the cost level and trends in China at present? Noteworthy, the term “low-cost country sourcing” is scarcely used in scholarly literature, but more frequently used in the industry. The most logical explanation to this is probably because it is difficult to give a stringent definition to the term “low-cost country”, as the term is completely relative; a country considered “low-cost” by country A is not necessarily considered “low-cost” by country B. To facilitate the discussion, we introduce the term comparative price level which means “the cost in one country as a per cent of the cost of the same good or service in another country, when prices in both countries are expressed in a common currency, with the official exchange rate being used for currency conversions”.

Comparative price level: A comparative price level is defined as the purchasing-power parity divided by the exchange rate. Purchasing-power parity (PPP) in turn is defined as the number of currency units required to buy goods equivalent to what can be bought with one unit of the currency of the base country or with one unit of the common currency of a group of countries. Definition from United Nations Statistics Division ([http://unstats.un.org/unsd/methods/icp/gdp/gdp06\\_htm.htm](http://unstats.un.org/unsd/methods/icp/gdp/gdp06_htm.htm))

With wage increases typically ranging from ten to twenty percent per annum, the economy overall seems to

be healthy after all as productivity outpaces inflation from a macro-economic perspective (approximately 11 vs. 7 percent, respectively). There seem to be a "buyer's (i.e. employer's) market for low-qualified labor in second- and third-tier cities where cost levels are still comparatively low. In contrast, the opposite seem to hold in first-tier cities like Shanghai and Beijing where the supply of top notch sourcing professionals is getting increasingly scarce and expensive. Alas, at too many international procurement offices (IPOs) of Western multinationals have adopted an HR strategy which implies continuous over-bidding for talented staff, leading to escalating salaries approaching European and US levels. For instance, a salary for a regional sourcing manager amounting to US\$4,000 in Hong Kong easily translates into US\$7,000 in Shanghai. A Director for an IPO of a European manufacturer with operations in China stated that "if I would ever build up an IPO in China again, I would never do it in Shanghai as costs are getting out of control". Another example is a European mid-sized manufacturer of sanitary fittings that gladly paid their China IPO director a yearly salary of US\$400,000. As with most other things in China (and elsewhere), you get what you pay for. If you want to recruit and retain the best, you have to dig deep into your wallet. Some go as far as describing the phenomenon as a "Hollywood effect" where the stars capture the lion's share of the cake.

It is important to keep in mind that China is a country in transition, where low-end production is getting decreasing incentives and support in favor of production of more high-end goods with high quality and technology contents. This transition is highly endorsed by the central government and is also manifested in the recent new VAT regulations where low-end products such as basic raw material can be subject to a cost increase amounting to 17 percent. As a result, it becomes a necessity to adapt the sourcing strategies accordingly, so that the range of goods being sourced follows the maturity level of the supplier base. If China has been a supply market for low-end goods, it is definitely time to develop sourcing capabilities for high-quality and high-tech goods. China will simply not be the optimal sourcing location for low-end goods for a very long time ahead.

Global buyers should also take the long transportation time into consideration as it normally takes 3-4 weeks on the sea from a Chinese port to a European or US port. It would add 1-2 weeks when the goods are transported inland. This means about five weeks in total, which is comparatively long compared with when they sourced locally. Moreover, there are a lot of hidden costs that needs to be part of the total cost of ownership (TCO) calculations. As a result, it is common practice in auto part sourcing to require more than 30% total cost reduction compared to local sourcing, to justify switching a supplier. Add recent oil prices in excess of US\$100 per barrel and the above mentioned VAT rebate exemption for a chunk of your supply portfolio and your TCO calculation might look all but pretty. Besides transportation, inventory and warehousing costs, there are also other potential hidden costs in your supply chain – costs for return of defect goods, cost for less flexibility in production schedule change and so forth. Again, anticipation through forecasting is paramount – scenario analysis can definitely help you to better cope with various outcomes.



So how long will China remain competitive from a procurement perspective? A study conducted by Supply Management Institute in 2005 among German multinationals indicates that domestic (i.e. German) suppliers will continue to have a very dominant position today as well as in the near future (Fig 3). Hence, the discussion about an offshoring wave in Germany may be exaggerated (Baily & Farrell, 2004). In other words, German suppliers seem to remain internationally competitive on a medium term. In line with expectations, China will drastically increase in importance, apparently at the expense of Southern European and Central European suppliers. A relatively high gain in importance is expected for India as well. To sum up, it seems that the supplier base currently located in Europe, outside Germany, will partially shift towards low-cost regions in Asia. Interestingly, as opposed to other European countries, Germany sources a comparatively high number of goods and services in Turkey. Although industrial structures may play an important role, one cannot neglect the large share of Turks who live in Germany. Most likely, their knowledge about the Turkish language and culture facilitates sourcing operations there.



### **The War for Talent Keeps Raging**

The War for Talent Keeps Raging

The situation is complicated further with an education system that faces difficulties to meet the current requirements from the companies operating in China. Firms have had concerns about HR management in China for long: many times, it has proven very difficult to find talent with adequate problem-solving skills,

creativity, as well as communication and leadership skills. Still, the Chinese education system is often too much focused on memorization and imparting knowledge than on developing essential soft skills.

The problem does not end with recruitment of employees – retention and further development are crucial elements as well. Although companies in West often complain about the rigid and stale labor markets, the dynamics of the Chinese labor market has its caveats. In some functions such as sales, it is not uncommon with a staff turnover rate exceeding thirty percent per annum! It is not difficult to realize the vast amount of resources that need to be put in place when a third of the organization has to be rebuilt every year.

As procurement is becoming a key strategic weapon to gain and maintain competitive advantage in today's globalized economy, HR as a supportive function has got a pivotal role to ensure effective and efficient operations. Successful recruitment and retention do not only translate into increased productivity of each individual within the organization, but also creates long-term synergies by facilitating career development, team work and a stronger and more cohesive corporate culture that competitors have a hard time to imitate. In other words, getting people in China right, is getting you company right. Due to the long absence of supply chain management in traditional Chinese education until recent years - irrespective of the considerable gap between the Chinese education and multinational companies' requirements, and moreover the massive need for supply chain talent which must be met as soon as possible, staff training in this case is deemed to be an effective way to close China's current supply chain talent gap.

The real challenge to the firms which are accustomed to the old, less restrictive labor environment is that how to adapt and comply to the newly introduced labor laws. Some companies like Wal-Mart, LG and Huawei take radical measures to lay off their workers and there are no doubts that they are under fire by the public opinion. Other companies are more willing to face the challenge. Ford Motor Company has instructed its assembly plants in China to educate its suppliers on the new labor law. The new labor law represents China's overall legal system moving in the right direction – generally speaking more in the direction toward a social-democracy like Germany rather than a more libertarian economy like the US. From long-term perspective, the investment in improving working environment and working conditions will hopefully pay off as increased loyalty and motivation of workers will eventually translate into increased productivity.

Chinese buyers face a challenging situation as they have ambitious cost savings targets on one hand, while simultaneously serving as a link between the domestic supplier base and the own organization. Consequently, these challenges require purchasing managers with strong cross-cultural management skills; such skills are truly scarce in supply. Interestingly, most failures by MNCs are caused by ignorance of culture differences. For example, when your local sourcing team contacts the domestic supplier about a delayed shipment, to find out that the sales manager of the supplier is “entertaining a customer at the local karaoke club and must not be disturbed by such trivialities”, you have to stay firm and consider what supplier management in China really means – even though it may contradict your perception of how to appropriately do business. Leading companies are managing to build up significant competitive advantage in global sourcing operations by focusing on the right leadership in four areas: (1) integration between IPOs and the head procurement office; (2) recruitment and development of sourcing talent; (3) quality assurance, and (4) controlling of hidden cost elements through improved spend visibility.

Benefits are becoming a tool to facilitate retention, alas again adding to the total cost to company. In times where companies in China bid over each other to recruit the best talent, it is important to keep in mind though, that pay is one of the least important motivators, but potentially one of the biggest de-motivators; pay too little (i.e. under market average) and your procurement staff will be dissatisfied. Pay too much (i.e. above market average) and the motivation increase is negligible. This fact has been repeatedly confirmed through extensive research (most notably through Herzberg's work on “hygiene factors”) and no less true when sourcing in China. Instead, clear career paths, meaningful job tasks and good relationships with the IPO managers are far more important (as long as staff are not underpaid that will say). Certification training, job rotation and international work opportunities can help breaking the “glass ceiling” many Chinese sourcing professionals are experiencing at the IPOs. It is also a fact that the new generation of sourcing professionals is extremely savvy and not willing to be treated as cheap labor and work under sweatshop conditions.

### **Getting Your Products Across**

Global sourcing brings big challenges to logistics. From the China side, the government is has mandated to improve the efficiency of logistics in the latest five-year plan. There is heavy investment in logistics infrastructure: highway, railway, seaport and airport. More than 20 provinces and 60 cities have initiated logistics development plans. For example, Shanghai is building more logistics zones including the Yangshan



Deep-Water Logistics zone, Waigaoqiao Bonded Logistics Park, Pudong airport logistics park as well as Northwest Logistics Park. Favorable tax policies have helped to facilitate the development of the industry. The importance of logistics is seen in the handling capacity of the Yangshan Deep Water Port, which handled 1.6 million tons of cargo worth US\$22.7 billion in the first four months of the year, statistics showed.

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However, beside the infrastructure efficiency, another big challenge in China is the fragmented logistics market which is highly visible in everyday life. Go for a walk down the street in any Chinese city, you will soon see the DHL truck being lined up by plenty of "mom-and-pop biker logisticians". This results that the cost of logistics inside China as applied to goods is about double that in the United States and Europe due to lack of economies of scale and the prevalence of bottlenecks. The fragmentation of the logistics market and low competences of local logistics providers cause problems across all industries. Here, the OEMs need an efficient logistics service provider to ease their burden so that they could focus on their core competences in assembling and designing cars. Logistics efficiency improvements would have a dramatic impact on production schedules, sales plans and even next generation designs.

### **Beyond China Sourcing – What's Next?**

As mentioned earlier, China has been hot for long, and how long will the country remain hot as a sourcing market? What's currently on the CPO radar screen? If you ask a Western purchasing manager, the answer is often Vietnam. Clearly, as China is becoming more expensive, Vietnam (and also Cambodia, Philippines and Indonesia etc.) is gradually becoming an increasingly attractive option nowadays not only for low-end supplies. But to look even further ahead into the future, it is interesting to ask the Chinese purchasing managers. Apparently, they seem to be less risk averse, and more focused on some really hefty cost cutting. Especially in industries far back in the supply chain such as sourcing of basic raw materials and other commodities where increasing volumes are being sourced South America and Africa. While the central government in China has its own economic and political agenda to promote, they have helped Chinese firms establish relationships across the world with a view to strengthen their supply of base metals and oil. They have also facilitated the opening up of new trade relationships, especially in Africa and Asia that can serve as an effective counterbalance to the existing ones with western countries, often "less burdened by political policy" as some claim.



Besides the endeavors in Africa, one should also not forget that an increasing number of Chinese multinationals, such as Haier and Huawei, are both manufacturing and sourcing in traditional "high-cost countries" such as North America and Europe – partly in order be closer to important consumer market, but also partly to get access to new technology by investing cash surplus. In other words, Chinese suppliers make huge efforts to become global market players. The traditional strategy has been to start out as a relatively anonymous supplier to Western OEMs, then gradually acquire and build technology and eventually start building their own brands. For example, the rising of the world's largest microwave oven producer Galanz took this path. To accelerate technology transfer, the government now encourages foreign direct investment in research and development. Some Western companies gladly jump onto the train to tap into the domestic R&D capabilities whereas others do it more reluctantly in order to not miss out business opportunities. We have seen it all before in industries such as textile, electronics, and shipbuilding. With a superpower like China, complex products in aerospace and automotive are all next in line to be transferred – whether you like it or not, it's going to happen.

The tidal wave of China sourcing is here. However, there are weaknesses that Chinese suppliers need to overcome in certain areas. Although there is an abundance of capable suppliers available, many still suffer from short-sightedness and inadequate quality thinking, especially in industries such as aerospace and automotive where long-term orientation and collaborative capabilities are key. So there is still some way to go before the tidal wave can continue along its path. If the 20th century belonged to the West, the 21st century seems to be devoted to China. With the privatization and liberalization of trade policies, this is a joyful fact for all parties involved in global sourcing initiatives. If things turn out well, it may very well be a

new great leap forward. The globalization circle will continue to close, and arbitrage opportunities around the world will continue to be eliminated, one by one. It is yet to be seen where the next "sourcing hotspot" will emerge. With skyrocketing oil prices and a plunging dollar, could the US potentially be next in line?

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