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NEWS AND TRENDS

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Mario Adamo

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Oshkosh Opens Procurement Office In China

Oshkosh, a designer, manufacturer and marketer of specialty vehicles and vehicle bodies, has opened an Asia Procurement Center in Shanghai.

Oshkosh chairman and chief executive officer said aggressive international growth leaded their business strategy. Opening a procurement office in Shanghai allowed them to support our global manufacturing efforts by leveraging a local supply of parts, which enhanced their long term competitiveness and strengthens their leadership position in the markets they serve, Broadening their global footprint with local offices increased the scale of their operations, which was key to fueling their future growth."

The company currently has manufacturing facilities in 11 countries and additional service operations in 16 countries. Oshkosh's products and services are sold in more than 130 countries across the globe. For Greater China, Oshkosh also has offices in Beijing and Hong Kong.

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US$23 Billion PC Components Purchases From China For Dell

Global computer manufacturer Dell says that it plans to make a purchase of US$23 billion in computer components from China this year and will increase the purchase value to US$29 billion next year.

Dell says it does so to lower the cost for PC manufacturing. CEO of Dell told local media that China was very important for Dell's global supply chain and Dell would make a total purchase of PC components worth up to US$70 billion from China from 2007 to 2009.

"Made-in-China" products are becoming increasingly popular among international manufacturers because of its big variety. Dell is not the only manufacturer that purchases from China to reduce its cost and keep competitive. In November last year, Cisco, one of the world's largest router, exchange and Internet equipment manufacturers, announced that it would bring its total purchase from China to US$16 billion in the coming five years.

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Ford opens door to increased global sourcing

Ford’s product development chief said Ford was set to ramp-up its global sourcing operations, The Detroit-based firm expects to cut its engineering costs in North America by 30 per cent as part of plans designed to cut complexity and up sourcing levels from overseas.

Ford posted losses of $2.7 billion in 2007 and $12.6 billion in 2006.Speaking at the SAE International World Congress in Detroit, He also said that the company’s current restructuring drive aimed reversing significant losses over the past two years.

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Cisco steps-up sustainability efforts in China

Technology giant Cisco is to step-up its sustainability programme in China, as part of its corporate strategy in the country.

The company first announced a $16 billion multi-year innovation and sustainability initiative in November 2007, focusing on areas such as procurement and training.

The next stage in Cisco’s programme will involve the signing of a memorandum of understanding with China’s Ministry of Commerce, in an attempt to develop business process outsourcing within the country, and improve green research and development.

Cisco chairman and chief executive officer said the next stage of our strategy for China reflects the country's importance to Cisco's global growth strategy and to their long-term business model, built upon next-generation innovation in collaboration and Web 2.0 technologies, He also said Cisco's public-private collaboration within China not only helps accelerate these business efforts, but also helps the 1.3 billion people and growing number of entrepreneurs within the country gain access to social and economic opportunities afforded by the Internet.

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Wal-Mart starts ‘green’ drive with Chinese suppliers

Wal-Mart is to hold meetings with thousands of its Chinese suppliers later this year as part of its drive to reduce waste and cut emissions at its factories in the country.

The company, who have already set a target of one day producing no waste and using energy only from renewable sources, has hired an outside consulting firm to help them push through their agenda in China.

The company's chief executive, told a Wall Street Journal conference in California that they started a very aggressive program in China that is not only going to deal with environmental sustainability, but is also going to deal more aggressively with the issues of sourcing in China, Wal-Mart is also pushing its suppliers to cut back on the amount of packaging they use by five per cent by 2013.

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China's soaring inflation sparks fears of unrest

Inflation in China hit an 11-year high in February, fuelling concerns of demonstrations in the country.

The rise has largely been attributed to soaring food prices in the country, with the 8.7 per cent rise recorded by the National Bureau of Statistics last month well above the 8 per cent forecast by analysts.

Officials in China – which has been hit by a particularly severe winter – are freezing the price of key commodities in an attempt to tackle the problem.

The latest figures come despite huge interest rate rises in the country over the past 12 months, increases that are likely to be repeated in the months to come.

One of the major concerns for European companies operating in the country is the threat of widespread unrest if the rises continue.

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Peugeot opens door to greater China sourcing

French carmaker PSA Peugeot Citroen is to ramp up its procurement operation in China, according to the Dongfeng Motor Corp - the company's joint venture partner in the country.

Peugeot sourced 350 million euros of spare parts from China as part of the tie-in over the past three years, and that figure is set to almost double by 2010.

The venture now involves 326 Chinese suppliers, and Dongfeng claim that Peugeot are set to double staff numbers at its Shanghai-based procurement centre over the next two years.

Peugeot's plans follow similar announcements from the likes of Volkswagen, Ford and General Motors, all of whom have said they plan to step-up their China sourcing operations in the near future.

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Tesco takes express route to heart of China

The UK's biggest retailer, Tesco, is set to open its first Tesco Express store in Shanghai as part of an aggressive overseas expansion plan.

Tesco is currently spending 80 per cent of group capital on its operations outside of the UK, where it holds a 32 per cent market share.

The move follows similar roll outs by the company's French and US rivals, Carrefour and Wal-Mart, as they look to cash in on the potential of one of the world's fastest growing economies.

Tesco's chief executive believed that earmarking China, alongside Turkey and the US, as the areas that will be crucial to achieving his company's aim of generating at least half the group's revenue overseas in the next five-to-ten years.

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Vietnam is the Next Hotbed for Offshoring

Vietnam, with the help of Western corporations, is becoming an increasingly strong force in capturing offshoring and outsourcing work from developed economies, growing its already sizable presence in low end goods while successfully moving upstream into higher end manufacturing and service offerings.

Over the past decade, Vietnam has built a decent business in basic goods such as apparel, shoes and bicycles, based on its low labor costs. Companies chasing lower labor rates are already increasingly moving production to Vietnam.

But the country is now looking to advance up the supply chain, following China's so far successful model of facilitating entrepreneurship and foreign investment while the Communist government maintains tight control over politics and social policy.

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"Common sense" approach to procurement needed in China, leading figure claims

Procurement organizations working in China need to adopt a common sense and flexible approach if they are to be successful in the country, according to a leading figure.Director Marketing Sourcing EMEA, Nokia,who has worked in China for the past seven years, said that business in China was not based on same common laws seen in the West, but centred on the notion of "Guanxi" - defined as a network of "personal relationships".

He also warned that those leading procurement and sourcing operations needed a thorough understanding of "Guanxi" and its potential implications when doing business in the country.

He said that the setting-up of a multicultural team with a sound knowledge of the supply base and local market, in addition to forging relationships with local government, was an essential element in ensuring success in China.

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AstraZeneca to open China sourcing centre

Pharmaceutical giant AstraZeneca is to open a sourcing centre in China in a move the company hopes will help it achieve cost savings of 10 per cent within the next three years.

The company has said it aims to source $100 million of API (active pharmaceutical ingredients) from the country by 2010 and eventually expected 90 per cent of its APIs to come from China.

The Anglo-Swedish company currently purchases $25 million of it annual goods in China but plans to purchase that amount during the second half of 2007. AstraZeneca presently makes 85 per cent of its own APIs, outsourcing the remainder.

The company said that it planned to establish the sourcing centre in Shanghai, with the facility also providing research and development services.

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INTERVIEW

Mario is the VP Procurement and Supply Chain of BlueScope Steel Asia, with deep experience developed for more than 20 years in industry. Mario is responsible for all operations across Asia in Thailand, Malaysia, Indonesia, Vietnam, Singapore and China

Throughout his career, Mario has also implemented several process, people and organizational transformations to deliver best practice procurement across all types of spend to deliver significant sustainable savings.

Introduction about BlueScope

BlueScope Steel is the leading steel company in Australia and New Zealand, supplying a large percentage of all flat steel products sold in these markets. The company's products play a big part in people's everyday lives, being vital components in suburban houses, landmark buildings and structures and popular makes of cars.

Globally, the company's turnover was $10 billion in 2007, focused mainly on selling flat products to the construction industry with some marginal sales to the appliance and auto industries. The company has a large steel making facility in Australia with a production capacity of 6 million tons per year. 80% of the steel produced in this facility is used internally by the company downstream coating and painting facilities making pre-engineered building solutions and building components and located throughout the whole of Asia (e.g.: China, Indonesia, Malaysia, Vietnam, Thailand and Singapore). Additionally, BlueScope also owns a large steel making facility in the US with a production capacity of 2 millions tons per year serving the North American market.

The company's success and growth has been achieved by developing leading edge patented coating and painting technologies that allows BlueScope to occupy a leading position in the high end of the market based on guarantees that its products last longer in terms of durability and colour integrity

In China, BlueScope Steel operates two businesses: BlueScope Steel China and BlueScope Buildings. The company now holds the number one position in pre-engineered building and premium steel building products in China. It is one of Australia's leading manufacturing investors in China with ties going back to 1918

Holding advanced technology in China, the company is one of the leading suppliers of ZINCALUME, with 250,000 tons capacity at its mid stream Suzhou factory supporting 2 brands (Butler and Lysaght) manufactured in their 6 downstream operations located in Beijing, Tianjing, Shanghai and Guangzhou.

Procurement at BlueScope

Implementing a domestic strategy, the company buys nearly all of its material requirements in China (with the exception of (1) some of the capex equipment requirements which are imported from the west and (2) of Aluminium and Zinc which are sourced globally). The total spend sourced locally amounts to approximately $200 million a year. Similarly, the Chinese facilities only serve the local Chinese market as high tariff barriers on steel products make exporting from China uncompetitive

Implementing a domestic strategy, the company buys nearly all of its material requirements in China (with the exception of (1) some of the capex equipment requirements which are imported from the west and (2) of Aluminium and Zinc which are sourced globally). The total spend sourced locally amounts to approximately $200 million a year. Similarly, the Chinese facilities only serve the local Chinese market as high tariff barriers on steel products make exporting from China uncompetitive

The company also has implemented a global procurement network which includes all key procurement heads globally. Taking Asia as an example, this network is now attempting to implement low cost country sourcing opportunities by leveraging the spend at the regional level across the various countries on common categories. Currently, only a limited number of categories are sourced globally (paint, aluminium, zinc), however BlueScope has as a target the objective of increasing this significantly in the coming 2-3 years by leveraging the capabilities of LCC countries such as China and Vietnam.

Mario indicated that he looks at quality, reliability, innovation and price as the 4 key factors driving his supplier selection process. To ensure procurement people's objectives are fully aligned with the company's objective, financial and non-financial indicators are used to measure procurement performance. Financial measures are quite standard and focus on the procurement function's ability to meet budget commitments. Non financial measures include the value of the spend under procurement control and compliance to contracts. Moving forward, the key objectives are to increase the value of the spend under procurement's responsibility and to increase the amount of categories that are leveraged regionally in Asia as well as globally in order to ensure all categories are sourced from the most attractive locations.

To help achieve this goal, procurement systems (e.g.: ERP system) will be implemented in the coming 2 years and rolled out throughout the whole of Asia in order (1) create better transparency in the spend across countries and BU's, and (2) to reduce the administrative workload of the procurement people allowing them thereby to spend a much larger percentage of their time on higher value added strategic sourcing activities

Regarding the inherent quality of the Chinese suppliers, Mario's perspective is that they are very fast learners and are for many of them operating at similar (and sometimes higher) levels of performance compared to their global competitors. Mario segments the Chinese suppliers into three categories: (1) backyard suppliers, i.e.: suppliers whose immediate future is uncertain; (2) middle tier supplier, i.e.: suppliers who are likely to remain in business but without the capability of supplying the high end of the market they operate in, and (3) top tier suppliers that operate at the premium end of the business capable of competing with anybody in the world.

Finally, in terms of characteristics of Chinese suppliers versus Western suppliers, the only salient difference pointed out by Mario is the much stronger emphasis put by Chinese companies on relationships compared to the more contractual type relationships that exist in the West. Mario's view is that the strength of these relationships are particularly useful in difficult times making it easier for the 2 parties to sit around the table in order to find a win-win solution rather than revert to a more legalistic approach which is more pervasive in the West

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Changing Rules for Export Manufacturers

Shanghai Business Review,September 2007, volume 4, issue 9
By Robert Smith, Partner of Ernst & Young

On the Processing Trade programme, Robert Smith asks if this engine of China's economic development is shifting gears?

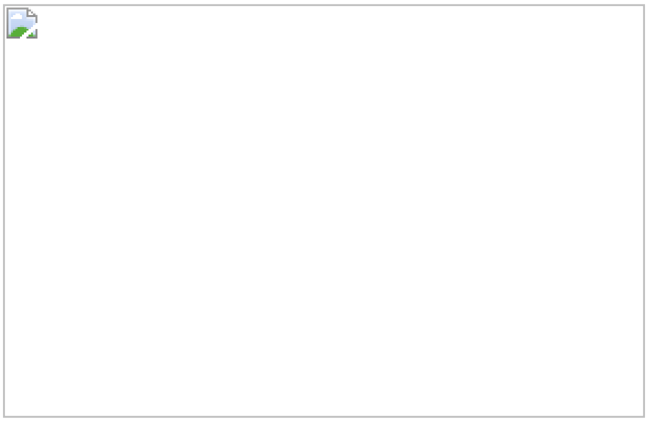
The magnitude of China's economic growth in recent years has been truly astonishing. Its GDP has expanded at an average of 9.6 per cent each year for over 25 years. Overall trade volume has exploded to more than USD1.76 trillion. The trade surplus, a staggering USD177.47bn, has ballooned to untenable levels. The waves are being felt on a global basis, forcing the government to rethink and reshape the strategies responsible for fueling this growth while focusing on long-term sustainable growth.

A cornerstone of China's success has been the growth in export manufacturing through a programme called Processing Trade. This programme has saved companies billions of dollars in duty and VAT costs. Without it, prices for Chinese export goods would be less competitive. But recent regulatory changes to Processing Trade are increasing costs, adding operational complexity and causing companies to reconsider China's status as a preferred global manufacturing base.

Introduction to Processing Trade

The Processing Trade programme permits a company to import raw materials free of duty/VAT for producing export goods. It is used by a majority of export manufacturers to legitimately manage indirect tax costs.

In just over 25 years the value of Processing Trade has increased 333 times from USD2.5bn in 1981 to USD831.9bn in 2006 and accounted for over 50 per cent of the total import/export value. In the first half of 2007, the Processing Trade total import and export value rose 17.6 per cent to USD440.9bn.



Two types of manufacturing structures are employed under the Processing Trade in China: Contract Manufacturing (进料加工)and Toll Manufacturing (来料加工). Most factories manufacture under Processing Trade using one of these structures.

Recent Changes to Processing Trade

There has been a flurry of new Processing Trade regulations promulgated over the last couple of years. As China endeavours to address trade, economic, social and political challenges, it is increasingly utilizing trade programs, such as Processing Trade and export VAT refunds, as "tools" to guide certain macro-economic policies and adjust long-standing investment patterns. The Vice Minister of MOFCOM, Wei Jianguo, said, "We are striving to improve the development of China's Processing Trade programme in a bid to promote trade balance and reduce the trade surplus".

Not all companies and types of production can enjoy the benefits of Processing Trade and certain restrictions apply

Prohibition List

There has always been a list of designated products which China does not allow to be produced under Processing Trade. The most recent list places prohibited products into the following categories: exported finished goods; imported raw materials; and combinations of finished goods made with certain imported raw materials. Prohibited products can be manufactured for export but the raw materials cannot be imported on a bonded basis. The following recent policy adjustments, among others, have significantly expanded the product coverage of the Prohibition List over the last year:

- Decree No. 139 and 145 (September 2006) stated that products with a 0 per cent export VAT refund rate would be placed on the Prohibition List;
- Announcement No. 82 (November 2006) and Announcement No. 17 (April 2007) updated and added items to the List as well as consolidated different Prohibition Lists;
- Supplement to Announcement No. 17 (July 2007) included additional items and clarified others that are not on the list;

Many of these rules were confusing, contradictory or inconsistently interpreted by various local authorities. From now on, the authorities will no longer issue a formal regulation every time the Prohibition List is updated. Rather, it will be updated online and companies must monitor the changes. The ease with which the online Prohibition List can be revised is likely an indication to expect future changes, possibly both additions and deletions.

Restricted List

A new “restricted” category was added to the changing landscape of Processing Trade. On 23 July Announcement No. 44 created a list of restricted products that covers over 1,800 tariff codes and places monetary and geographic restrictions on export manufacturers. The new restrictions can have a serious impact on a company’s supply chain, cash flow and operating location. The following restrictions are imposed on affected products:

- Companies must post cash deposits for the estimated amount of their duty/VAT liability. Companies with an A or B grading are allowed to post only 50 per cent of the amount, while C grade companies will have to post 100 per cent. If an A or B grade company is already located in middle and western China, then the deposit requirement may be waived.
- If a factory to manufacture restricted products was not approved to conduct Processing Trade before 23 July, then the company will not be allowed to conduct this activity in the coastal provinces. A company currently manufacturing under Processing Trade without import/export rights must obtain the rights before 23 October to be able to continue producing such products.
- The restricted list applies to E-handbooks but does not apply to special zones (e.g., export port processing zone, bonded zone, etc.) and special types of bonded factory transfers.

Companies must receive approval from MOFCOM and Customs by 23 August in order to continue under the old rules (i.e., not required to lodge a cash deposit) for a period of time. The information contained in a registered contract cannot be changed and once the total quantity has been reached or the handbook expires, then the new rules will apply. Thus, companies producing goods on the Restricted List should act immediately to register a contract and obtain a customs handbook.

What’s Next?

It is tricky to try and predict the next Processing Trade changes to be introduced by the Authorities. But we do expect there to be more changes.

The Prohibition List is likely to be in a continual state of revision. This List is now published online and this gives the authorities greater flexibility to add and delete items. The Restricted List will be monitored and likely adjusted from time to time. They may even initiate certain adjustments where the results differed from the expected outcome.

Currently, HS codes are being used to select the affected products. This is not a perfect method, and it may be plausible for additional criteria, other than just the HS codes, to be contemplated in future changes.

An even more radical position may be to ask whether Processing Trade, in its current form, has outlived its usefulness. If so, then fundamental changes or a scrapping of the entire programme may be necessary. The authorities are contemplating alternatives, but such structural change will not come easily.

Common Issues

Processing Trade provides a huge cost savings to export manufacturers. To enjoy the benefits companies must understand the regulations and employ operational procedures to ensure compliance. Failure to do so will result in additional duty/VAT liabilities payable. Given the large volumes and quantities of goods manufactured for export, the resulting costs can be material and usually come as an unwelcome surprise. A few of the most common issues are listed below:

- Inability to reconcile bonded inventory – It can be difficult to appropriately track the usage of the bonded raw materials and often there is a large variance between the quantity Customs has in their records and the actual physical quantity in the warehouse.
- Domestic sales – Some manufacturers will sell goods to both the domestic and export markets. Bonded raw materials may be included in goods sold domestically. Domestic sales including bonded raw materials must be reported on time to Customs and duty/VAT paid thereon.
- Closure of a handbook – Many times it is too difficult for the operational staff to reconcile the handbook at the time of closure. Thus, the irreconcilable ending balances are “rolled forward” to the beginning balances of a new handbook. The irreconcilable balances then compound over a period of time and increase the risk exposure to the company.

We have seen many companies start operations under Processing Trade without detailed internal controls, policies and procedures in place to avoid noncompliance. Most who have faced a serious issue with Customs say they wished upfront time had been invested to design procedures that could have prevented the issue.

The Effects: Wait and See

Processing Trade has and will continue to play an important role in the development of China’s economy. The authorities are beginning to experiment with the programme as a “tool” to engineer and force changes necessary for China’s long-term growth. By prohibiting, restricting or encouraging production in certain industries or of specific products, they hope to nudge the economy towards higher value-added manufacturing.

The new regulatory changes can significantly impact company operations and future investment decisions. The authorities recognize that these changes negatively affect a number of businesses and are monitoring the impact. But they seem willing to accept a certain level of downside to address the larger issues such as the trade surplus, environmental pollution, limited energy and natural resources, balance of wealth in China and social order.

It will be interesting to watch as the effects from these changes are manifested in the economy. Companies will be casting a wary eye on implementation. The authorities are also eager to see if this experiment in tinkering with Processing Trade will pay off as expected. Either way, we will have to wait for a while to see how this all plays out.

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