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Global Sourcing – China Sourcing

from a German perspective

The Challenges of Globalization

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1. Introduction

In 2009, the People's Republic of China became the export world champion for the first time.¹ In 2018, it became the most important import nation for Germany for the fourth time in succession.²

Global sourcing is one of the many opportunities that have opened up in the course of globalization.³ In view of China's steady growth and unchanged importance as an export nation for the world economy, this work deals with a special form of international procurement: China sourcing.

This paper will first explain the concept of Global Sourcing and then go into the specific form of China Sourcing. At the beginning the development of the Chinese market as procurement market is considered briefly and an overview of chances and risks of the procurement concept is given.

2. Global Sourcing

In the functional area of procurement, four fundamental decisions have to be made. What is procured when, where and from whom?

The term Global Sourcing opens an answer to the question of "where". The geographical demarcation of the used procurement market takes place on local, regional or global level. Global sourcing means that a company regards the procurement markets worldwide as potential purchasing locations.⁴

However, the term Global Sourcing does not provide an answer to what, when and by whom exactly is procured. Globally sourced goods can be raw materials, consumables and operating supplies as well as unfinished or finished products. Global Sourcing does not ask when the procurement process has to be initiated or which supplier to choose.⁵

Globalization has made it possible to procure material from other parts of the world.⁶ The aim of global sourcing is to harmonize the target triangle of procurement of costs, quality and delivery readiness particularly well. This concern was already mentioned by Lockström in 2007:

¹ Cf. Faust (2013), p. 3.

² Cf. Statistische Bundesamt (2019), China zum vierten Mal in Folge wichtiges Importland.

³ Cf. Werner (2015), p. 2.

⁴ Cf. Weber (2018), p. 171 f.

⁵ Cf. Cf. Weber (2018), p. 165 f.

⁶ Cf. Lockström (2007), p. 18.

*"The aim of the [global] sourcing initiatives is to identify suppliers that can deliver maximum amount of value at the lowest possible total cost, at adequate quality levels"*⁷

Starting in the 1970s, many companies began not only to take advantage of worldwide purchasing opportunities, but also to relocate large parts of their value chains abroad. Thus, the transitions between manufacturing processes and procurement processes became fluid and often it is no longer or only with difficulty to differentiate whether international actions of a company, procurement or production are involved.⁸

3. China Sourcing

From a strategic point of view, the selection of a procurement country is an important decision that must be made during procurement planning. Many other decision-making processes depend on it. It affects the means of transport that can be considered, potential suppliers and the choice between direct purchasing or intermediaries.⁹

In this scientific paper, China is selected as one of many countries to exemplify the pros and cons of global sourcing and its development.

China was long regarded as a Low-Cost-Country (LCC). In LCC, the overall price level is lower than on the world market, which can benefit High-Cost-Country (HCC) in procurement.¹⁰

3.1 Development und Trends

Throughout history, Low-Cost-Country-Sourcing (LCCS) flows have occurred regularly. The development of the LCCS in the 20th century should be considered here. The clothing industry was one of the first to be significantly influenced by global sourcing.

In the 1970s, many textile companies and shoe factories closed in Germany. These developments could also be observed in other countries over the next few years, such as France, England, Sweden and Denmark. The companies outsourced their production to Southern Europe. At that time, wages there were very low, and it was possible to produce cheaply.

⁷ Cf. Lockström (2007), p. 3.

⁸ Cf. Ambrosius (2018), p. 462.

⁹ Cf. Krokowski/Lorenz (2018), p. 53

¹⁰ Cf. Lockström (2017), p. 1.

But wages also rose in Southern Europe and new sources of supply and production sites were sought. In the mid-1980s they finally found what they were looking for in Taiwan, China and India. Other markets were also opened up in Pakistan, Bangladesh and Vietnam.¹¹

But it was not only in the textile industry that China became more and more known and appreciated as a purchasing country. In 1998, the market volume for Chinese automotive components was only 490 million euros. By 2003 this figure had multiplied to 2,743 million euros.¹²

China's exports grew by 18.1 percent between 1978 and 2008. In 2009, the country thus became the world's strongest exporter - after all, in 2010 it became Germany's most important supplier.¹³

Germany's import figures from China continue to rise to this day. According to the Federal Statistical Office, they grew by 4.2 percent between 2017 and 2018.¹⁴ Today, less clothing is imported from China. Germany now imports mainly mobile phones, consumer electronics, PC and telecommunications equipment from the People's Republic of China.¹⁵

The country has experienced strong economic growth over the past twenty years. While its GDP in 2000 was still 1208.846 billion US dollars, in 2015 it was 10982.829 billion US dollars. The People's Republic has thus increased its GDP tenfold within twenty years.¹⁶ But China's growth is slowly levelling off; since 2012 the growth rate has tended to decline and is now averaging six percent per year.¹⁷

Today, there is discussion as to whether China can still be described as an LCC. Its rapid growth at both the economic and social levels, for example, has boosted wage levels. The World Bank now assesses China in a global comparison as a country with an income level in the upper middle range.¹⁸

¹¹ Cf. Merkel a.o. (2008), p. 49 ff.

¹² Cf. Bogaschewsky (2005), p. 81.

¹³ Cf. Faust, Peter (2014), p. 8.

¹⁴ Statistisches Bundesamt (2019), Aus- und Einfuhr (Außenhandel): Deutschland, 2016, VR China.

¹⁵ Cf. Faust, Peter (2014), p. 8.

¹⁶ Internationaler Währungsfonds (2016), China Gross domestic product, current prices US-Dollar.

¹⁷ German Trade Invest (2018), Wirtschaftswachstum;

Internationaler Währungsfonds (2016), China Gross domestic product, current prices US-Dollar.

¹⁸ Cf. Weltbank (2019), The World Bank in China.

3.2 Opportunities and Risk

The main objective of global sourcing is seen by many companies primarily in potential cost savings.¹⁹ The internationalisation of markets is creating competitive pressure, urging companies to use global sources of procurement to reduce their costs.²⁰

The main focus is on savings in factor costs.²¹ Labour, operating resources, materials and capital are the key factors in the company's environment that need to be addressed through outsourcing / international procurement.²²

Depending on the starting point or country of origin, the extent to which the People's Republic of China offers usable potential in the individual areas must therefore be assessed. While it makes sense for Western countries such as Germany, Canada and the USA to consider purchasing in the People's Republic of China, there are just as many countries in which there are hardly any noticeable differences in price levels.

But also, apart from price differences, buying in China can bring advantages. This leads to a higher number of potential suppliers. The buyer can strengthen his negotiating position. In global tenders, for example, price reductions can be recorded in 80 percent of all cases - without changing the original supplier.²³ In the event of unsuccessful negotiations, it is also possible to make alternative arrangements.²⁴ This means that the quality and price of the goods as well as the reliability and flexibility of the suppliers can be improved for the benefit of the buyer by means of global sourcing.

Furthermore, risk controlling can also be implemented through a broad diversification of suppliers. This is one of the reasons why it is possible to make purchases worldwide and not just in the People's Republic of China. A distribution of material sources leads to lower dependencies. In the event of insolvencies and production bottlenecks, it is possible to switch more quickly to other suppliers.²⁵

¹⁹ Cf. Krokowski/Sander (2009), p. 13 ff.

²⁰ Cf. Lockström (2007), p. 1; Faust (2013), p. 37.

²¹ Cf. Faust (20113), p. 37.

²² Cf. Krampf (2014), p. 55.

²³ Cf. Krampf (2014), p. 54.

²⁴ Cf. Faust (2013), p. 37.

²⁵ Cf. Faust (2013), p. 45.

Another positive effect of China sourcing is to find a potential entry into the People's Republic of China as a sales market. Local locations ensure awareness and open up sales opportunities in the future.²⁶

Of course, purchasing in China also entails various risks. Those risks can be divided into five categories for global sourcing. In the following, an overview was created on the basis of Werner, which shows the risks of China Sourcing, specifically tailored to China's situation.

It is imperative that such risks are subjected to a comprehensive risk evaluation on a case-by-case basis. A misjudgement can have fatal consequences, especially for small and medium-sized companies.²⁷

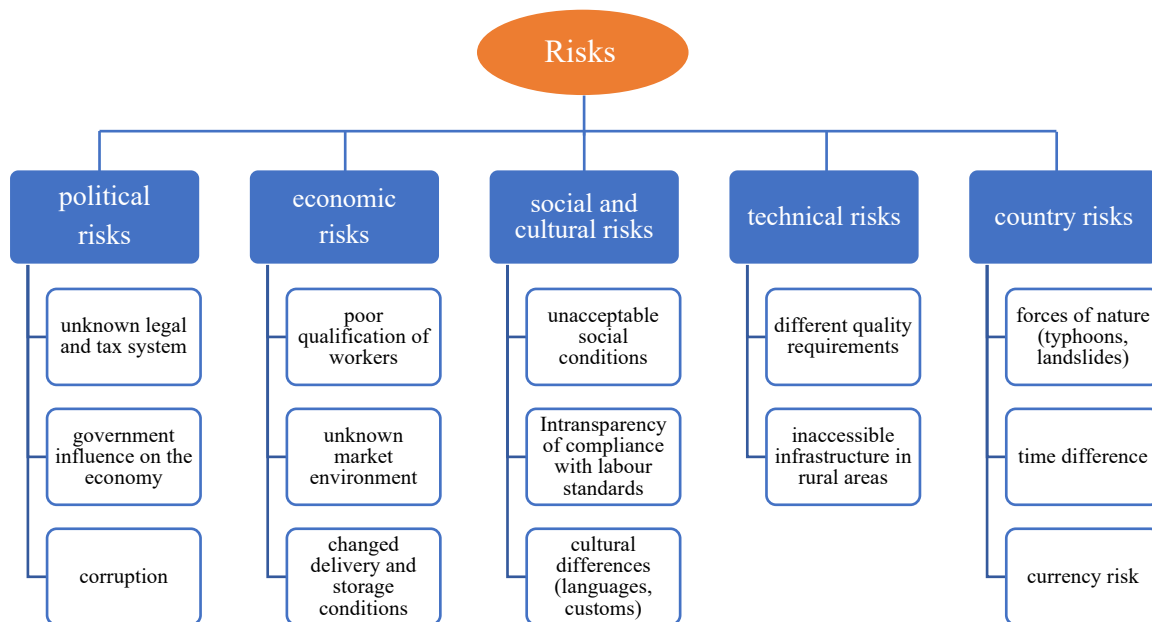


Figure 1 - Possible risks of China Sourcing at a glance
Source: Own presentation based on Werner (2015), p. 45ff.

In this paper two groups of risks will be discussed in more detail. It is particularly difficult to assess logistics costs on the one hand and supply flexibility in China Sourcing on the other.

In addition to fixed freight and customs costs, logistics costs include inventory, obsolescence and container costs.²⁸

²⁶ Cf. Krampf (2014), p. 55.

²⁷ Cf. Werner (2015), p. 45.

²⁸ Cf. Faust (2013), p. 38.

In China, logistics costs account for around 20 percent of GDP.²⁹ Logistics costs here are driven up by the geographical size of the country alone.

Freight can be transported westwards on the "new Silk Road" by rail. Since 2013, the trans-Eurasian route has offered a comparatively climate-friendly option for transporting goods directly from Chengdu and Chongqing to Berlin. It costs 8,000 to 9,000 US dollars to transport a 20-foot container from China to Europe.³⁰

The differentiation of the Chinese logistics market is also problematic. There are around 700,000 logistics companies in the People's Republic of China, 90 percent of which have fewer than 500 employees. Only five percent of the market is occupied by the four largest Chinese logistics service providers. Not a single one covers China in its entire geographical area.³¹

The second major risk of China sourcing is supply flexibility. The procurement process is becoming more complex and non-transparent. The time factor is becoming a problem. Transports from the People's Republic of China to the western world take up a lot of time, which also increases the transport risks. The replacement time increases and is inconsistent due to unforeseeable obstacles in the sourcing process and is subject to constant fluctuations. This collides with the interest in being able to easily compensate for fluctuations in demand.³²

Another difficult aspect is communication with suppliers in the People's Republic of China. In addition to the language barrier, the distance between customers and suppliers makes personal meetings more difficult and telephone conferences are also associated with high coordination costs due to the time difference.³³

²⁹ Cf. Faust (2013), p. 51.

³⁰ Cf. Helmold/Terry (2018), p. 162

³¹ Faust (2013), p. 52.

³² Cf. Krampf (2014), p. 56; Faust (2014), p. 38.

³³ Cf. Faust (2013), p. 39.

4. Conclusion

In conclusion, it can be said that global sourcing through globalization has played a very important role in many companies in the past. The aim of global sourcing is to save costs without compromising the quality of the goods and the supplier's ability to deliver. Today, manufacturing processes and procurement processes can no longer be clearly distinguished from each other. The Chinese market as a procurement market as an example of global sourcing has continued to grow after its blossoming in the 1970s. The People's Republic of China is a country whose price level is lower than in most Western countries, which still allows cost advantages to be realized. The market is often used by companies around the world to outsource certain parts of their value chain. The advantages of China sourcing are cost savings, a strengthening of the negotiating position with suppliers, risk diversification and a potential use of the country as a sales market. However, it is also necessary to calculate existing obstacles and problems by means of comprehensive risk controlling. High logistics costs, possibly limited supply flexibility and communication barriers make a successful supply relationship difficult.

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