

Considerations when Sourcing Products from Central and Eastern Europe **Published in FOCUS Magazine (British Chamber of Commerce Czech Republic)** **August 2006**

Alpha Management regularly works with SME sized companies looking to access low cost manufacturing from the countries of central and eastern Europe. More often than not, this is the first time these companies have tried to access an overseas supply base and without expert local support their approach to the local market often ends in disappointment and disillusionment with the prospects. Almost as often we are told by companies that they have already decided to source from China rather than central Europe because they have heard of the incredible cost savings to be made, yet there is a limited understanding of what it will actually take to do business in China.

It is a common assumption that global sourcing is the best option but all organisations looking to purchase products from overseas need to understand that as well as savings to be made there are also likely to be increased administration costs, longer lead times and localisation issues to overcome. For a global sourcing strategy to succeed there needs to be a real appreciation of these issues as well as an understanding of where in the global marketplace companies should look for the best suppliers for their particular product.

For example, although suppliers in the Czech Republic can generally deliver lower cost components, assemblies and products than suppliers in western Europe, the country is by no means the lowest cost area in the world. However, the country's long tradition of manufacturing and geographical position make it a high quality, reliable and convenient location to source product.

In general, it is probable successes will occur when companies look to outsource products with a high labour content, skilled / semi-skilled content, flexible labour requirements, large volumes, low set up costs, limited variability and a high product value per pallet / truck. Possible disappointments will occur when products have a low labour / skills content, small volumes, high set up costs, many different items, greater variability and a low product value per pallet / truck.

Even when organisations have a clear idea of where they might best source their particular product the process is still not an easy one. Common errors to avoid include sending out large bundles of drawings, issuing huge specs in English, insisting on 'home-country' materials and demanding prices with detailed cost breakdowns. Sitting back and expecting local suppliers to respond to enquiries with the same vigour as their western European competitors will not give the hoped for dividends. Whilst local companies might have excellent technical capabilities they are frequently let down by poor sales & marketing departments; quotations arrive late or not at all, contain too much or too little detail, there is no follow up. Suppliers often need to be helped through the contractual process and a close, open, honest, collaboration with potential suppliers, whilst more time consuming, will ultimately deliver the best results.

Some of the key points to be aware of when considering sourcing from overseas are outlined below:

Communications

Different business cultures, languages, time zones can all contribute to misunderstandings between companies and suppliers. The time taken to develop a business relationship will be considerably longer when interpreters are involved or there are only a few hours in the working day when direct communication by phone can take place. Travel to and from suppliers in far off locations is expensive both from a cost and time perspective. During the

set-up of a new supply agreement there will probably need to be frequent face-to-face meetings to ensure success. Trying to do this remotely using only e-mail and other tools will greatly increase the risk of miscommunication and failure. Establishing a local presence in the supplier country is one way to alleviate this problem, but this will increase costs.

Specifications

A common misunderstanding is that manufacturing techniques and methods are the same everywhere. Just because a supplier in the UK (who has supplied a company for the last 20 years) has an implicit understanding of a company's requirements does not mean a supplier in the Czech Republic will be able to interpret that from the bundle of specs issued to him. Simple things like paint drips or runs on a painted steel fabrication might be totally unacceptable to a UK quality department, yet unless a supplier is told at the start he will find it difficult to understand why this is a reason to reject his perfectly good (from a mechanical point of view) product.

Costs

When dealing with suppliers in low cost countries companies need to understand that low labour costs are only part of the price make up. Material and energy costs will most likely be at global prices, there may also be local taxes and duties, currency protection costs, as well as the cost of local representation. Long distance inspection requirements and extra shipping costs can quickly negate the benefits of a low cost workforce. Companies need to consider all aspects of the supply chain when identifying all aspects of the current total acquisition costs.

Lead Times

Global sourcing will increase lead times and to compensate for this purchasers will often increase their minimum order quantity. However financing and carrying this extra inventory is expensive and having to use faster, alternative means of transport in case of supply shortages will add significant costs. Careful inventory management and demand planning are essential elements in the success of the procurement process.

Length and Flexibility of Supply Chain

With many companies adopting lean manufacturing, minimum inventory supply chain strategies any disruption to this chain can be devastating. The solution is to ensure alternative sources of supply are readily available and this requires contingency planning. Perhaps a company's new, low cost, supplier in China has a manufacturing problem and quality inspectors don't pick it up until the container arrives at the factory gate. Not only will there be the time and cost to resolve the problem, but all the product already shipped but not yet delivered will be out of spec as well. Using another low cost Chinese supplier is not an option because the company needs the supplies immediately and returning to the original supplier cap-in-hand for a rush order will no doubt be very expensive!

In conclusion, global sourcing has the potential to take significant cost out of the supply chain and though there have been many successes, there have been even more recorded and unrecorded failures. The Czech Republic offers a seductive blend of convenience, low cost, high quality and an increasingly Euro-centric approach to doing business. However there are many potential pitfalls along the way and without people on the ground and expert local support it can be hard work to manage from hometown UK.

About the author:

Angus Mathews is a partner at Alpha Management Consultants and has lived and worked in the countries of central and eastern Europe since 1996. He is a Chartered Mechanical Engineer with extensive experience in supplier identification and sourcing projects across a wide range of industry sectors.

Alpha provides a complete market entry service for central & eastern Europe including project management of new investments (production facilities, R&D offices, service or distribution centres), sourcing and SCM of products & materials, market research, feasibility studies, supplier identification & qualification, grant applications, recruitment services and training.