



A&M INSIGHTS

Best Cost Country Sourcing: assessing an increasingly important boardroom debate

Deciding where you source your goods and services no longer means a binary choice between 'high-cost' or 'low-cost' geographies and vendors. With economies becoming more interconnected all the time, the decision to source and/or invest in a particular location is a much more complex conversation. Accordingly, the practice of best cost country sourcing (BCCS) is now widely practiced and is attracting an increasing amount of attention in boardrooms.

Over years of scoping and implementing BCCS initiatives, we have established key levers for companies that can make a difficult challenge more straightforward.

Glocalisation and the 'China plus' model

More than one year into the traumatic COVID-19 experience, economies are seeking to jumpstart their recoveries. Rebuilding has happened at different rates in different regions. For instance, less severe waves of infection in East Asia through 2020 allowed China and other manufacturing hubs like Vietnam to continue investing in infrastructure and capacity while Western economies struggled to navigate recurring lockdowns.

Unfortunately, the headaches for management teams do not end there.

- Companies need to continuously rationalise costs to defend and increase market share in competitive regions.
- Trade wars and tariffs are causing real logistical and financial difficulties for companies sourcing and trading internationally.
- Other geopolitical upheavals, from COVID-19 to Brexit, have increased the stress on supply chains.
- Whereas China is still a huge and growing market (in contrast to mostly saturated Western markets), China is not as cheap as it used to be when it comes to labour costs and sourcing options: management teams have begun to look for new alternatives.
- Advances in automation, supply chain and logistics technologies are complicating the issues of labour costs and capital investment planning.





These factors are causing boards to enhance their preparations for a ‘glocal’ future, where the default approach is neither a highly localised sourcing base nor a structure that prioritises global reach without a regard for local demands. The increasing popularity of ‘glocalisation’ as a term reflects a drive for sourcing that is global in scale and outlook, but which can respond to local preferences and norms in different markets.

Sourcing does not have to revolve around a one-size-fits-all solution. A more glocal approach to BCCS could involve establishing a BCC for Asian production sites and markets, a different BCC for operations in North America and another for Europe. As well as breaking footprint down by region, the overall strategy must take supplier capacity and capability into account, scoping solutions to find the best fit for the specific requirement (on lead times, reliability, volume, etc.)

While there may be capex, production and supplier network implications for management teams,

the long-term costs of risk mitigation and inbuilt diversification make a glocal approach a compelling alternative. Operating in this way can also mitigate some of the ‘softer’, qualitative aspects of best cost country selection such as cultural differences, language, time zones and expectations on standards.

With Chinese suppliers and costs becoming significantly more expensive compared to their relative affordability ten or twenty years ago, companies are questioning whether China will continue to be the default BCCS solution for manufacturing. ‘China plus’ has been a popular topic of discussion in recent years, but this diversification strategy usually focuses on other South East Asian nations like Malaysia, India, Vietnam and Thailand as the ‘plus’ country. For companies focused on European sales, the ‘plus one’ geography of choice might be in Eastern European countries like Hungary, Romania or Poland. Still, the decision for the right BCC mix and selection is complex (see Figure 1).

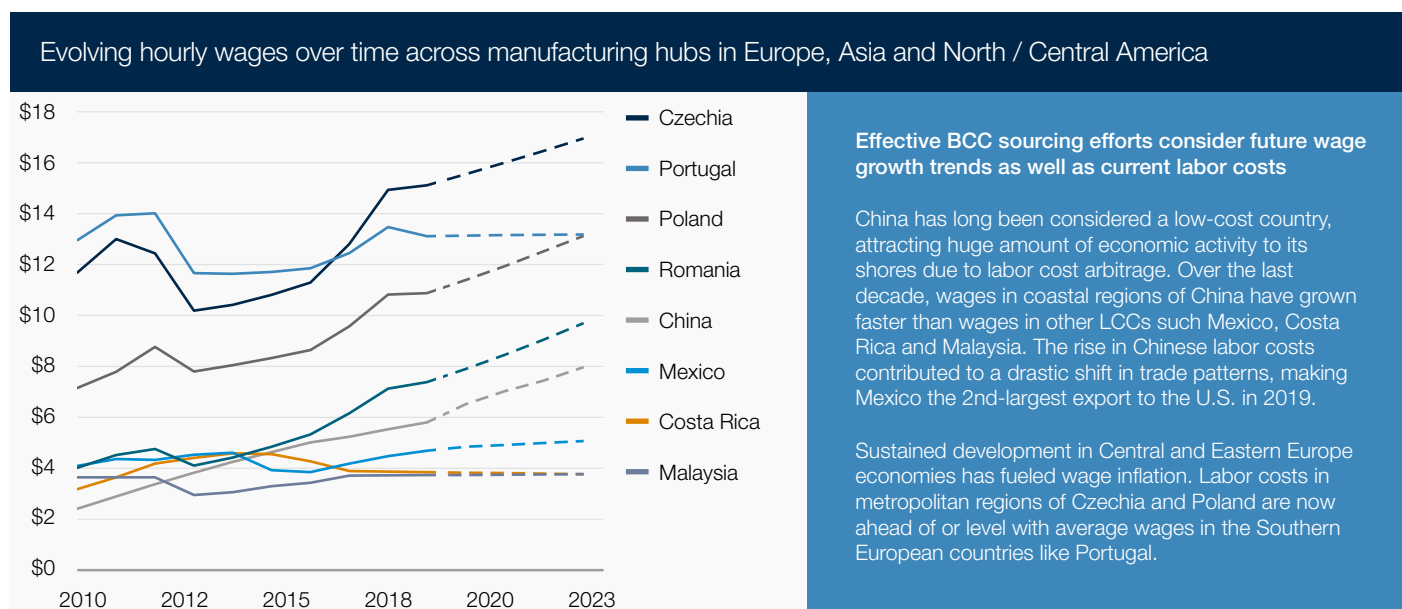
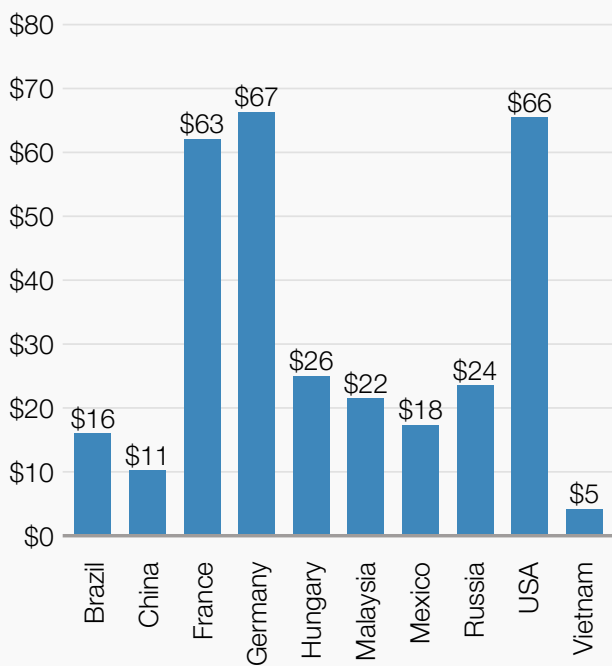


Figure 1: evolving hourly wages over time across manufacturing hubs in Europe, Asia and North / Central America.

As well as wage costs, productivity is a key consideration. Although developed economies often boast higher output per hour worked, economies like Vietnam and China are increasing their productivity at faster rates (see Figure 2):



Labor productivity, GDP (PPP) per hour worked, 2017



Increase in labor productivity GDP per hour worked, 2010 — 2017

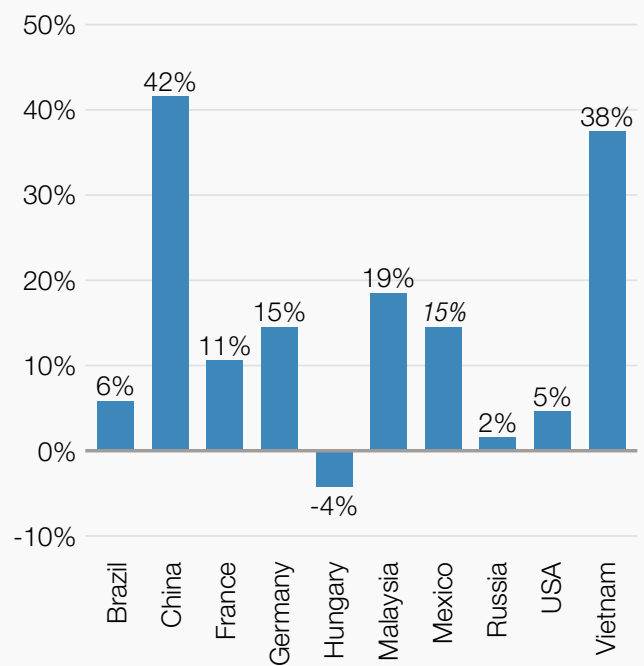


Figure 2: labour productivity is increasing at different rates in different markets.



Factors underpinning sourcing decisions go far beyond labour costs and productivity, encompassing elements such as the degree of automation in manufacturing, the ability to customise products for Eastern and Western customers and partners, availability of production know-how and capacities, transportation costs and lead times, tax, and so on.

It could be wise for organisations confronting these sourcing decisions to adopt a glocal approach – understanding that if Asia is a necessary component of a global supply chain, the ‘plus one’ country for Europe or other regions might be Hungary and not Indonesia. For companies, either not yet active on BCCS in Asia or looking for a better diversification of the Asian sourcing spend, a potential solution might also focus on Malaysia or Vietnam instead as an alternative to China.

BCCS: an underappreciated element of value creation plans and performance improvements

Why is sourcing such a topical issue in boardrooms?

One reason is simply the number of strategic goals that sourcing affects. Sourcing can ease or exacerbate pressures on costs, of course, but it is a central component of overall resilience and risk mitigation across the organisation.

The present difficulties companies are facing in accessing semiconductors, for instance, will have long-term effects on global industries such as automotive. A well-executed sourcing strategy should respond to unique market pressures in different sectors and geographies (see Figure 3). A company's approach to sourcing semiconductors – a highly concentrated market that requires very sophisticated industrial infrastructure – must be very different from the sourcing strategy for commodified goods like machined parts, textiles or mass-produced food products.

Key drivers of BCCS decision-making

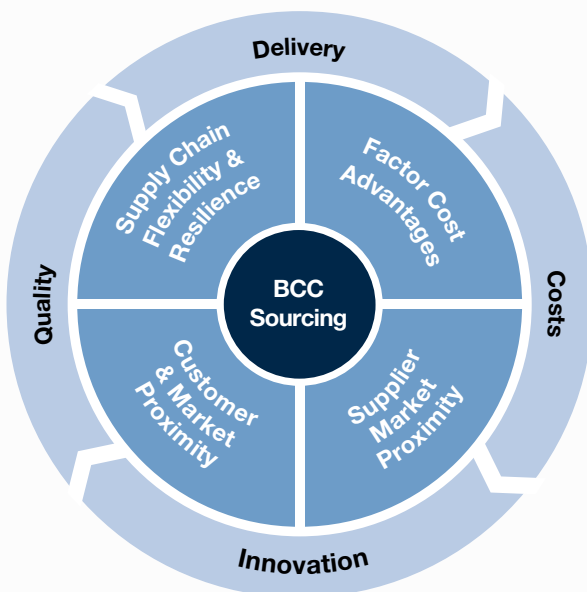


Figure 3

A well-executed BCCS strategy has many positive effects on growth, resilience and agility, but even so, companies looking to develop BCCS capabilities can encounter obstacles. Often, for instance, executives fail to anticipate the complexity of delivering BCCS optimisation programmes, which demand a nuanced understanding of the various global and local characteristics and derived strategies that affect sourcing as well as requiring advanced operational capabilities. In addition, inertia and resistance to change can present difficulties for management teams seeking to redesign operating models or deliver transformations.

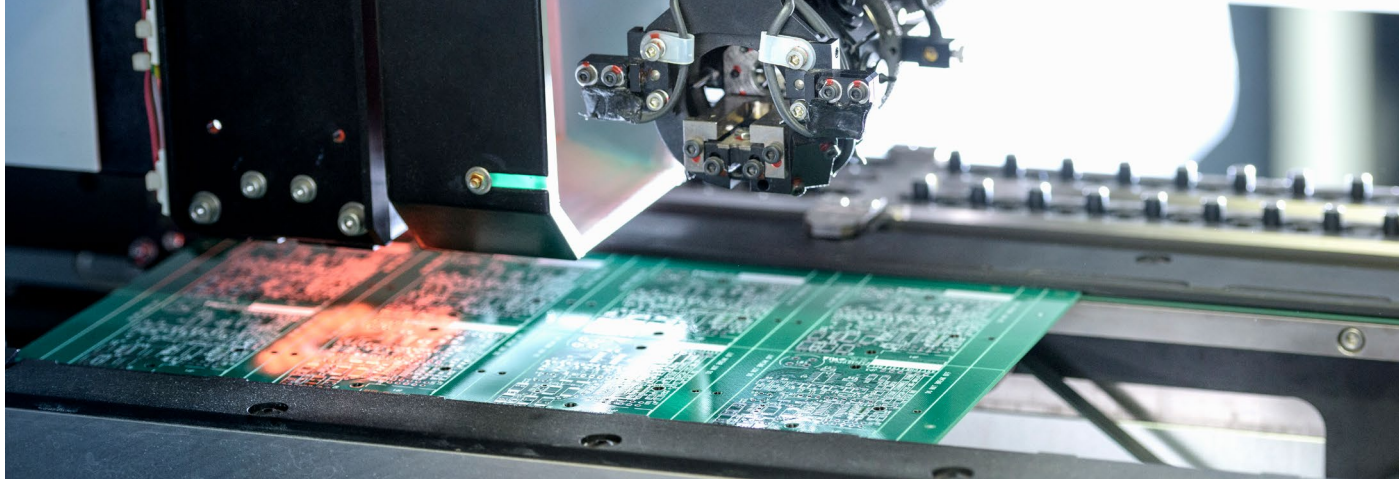
Best cost ≠ low-cost

When they hear 'best cost country', some management teams might automatically think of traditional 'low-cost country' (LCC) markets in regions like South East Asia, China, India or Eastern Europe. It is a mistake to confuse these categories. BCCS takes into account all elements of a company's relationship with a sourcing location, not just labour costs. BCCS allows companies to take into account the total costs of ownership, involving tangible expenditures (labour, transport, tax etc.) as well as more qualitative outcomes like cultural synergies, production and engineering capabilities, and ease of supplier management.

For example, although labour costs may be cheaper in one country, integrating a supplier from that territory into a company's global supply chain may pose challenges around logistics and taxation – to name just a couple of examples – that make that country non-viable. In this situation, another territory that offers a better balance between labour cost and logistical as well as duties feasibility would be the 'best cost country'.

Lower costs in areas like labour will always be a lever for value creation, but deciding on a best cost country is usually driven by more than just savings potential. Sourcing decisions can play a role in guiding broader operational strategy. A company seeking to substantially grow its sales in South-East Asia, for instance, may have particular requirements relating to technologies and specific goals relating to shipment lead times, etc., that make it logical to establish close relationships with suppliers and partners in the region. (And, of course, organisations are also able to fund transformation objectives with the costs saved through BCCS.)

Although companies can be surprised at the degree of complexity that goes into selecting a best cost country and ultimately the right supplier in that territory, the impact of a well-executed BCCS strategy can be transformative. At A&M, we have helped organisations navigate the sourcing process from end to end, encompassing portfolio assessments, geographical and regional screening, tendering, negotiations, supplier auditing and selection, contracting, supplier integration, ongoing performance management and more. In a volatile economic climate, the advantages of adopting a careful approach to risk mitigation with BCCS are clear.



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Our professionals have both operational and advisory experience together with a proven track record in leading businesses through tough, complex situations. To speak to us about our experience in BCCS and corporate transformations, please visit our website or speak to one of our contacts below.

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