

Going Beyond Price

The Value of Robust Supplier Selection Criteria



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Qualifying Foreign Suppliers Beyond Pricing Competitiveness

What is the biggest threat facing importers from China? Many rush to cite IP theft in the wake of recent high profile cases, while others claim rising labor rates or even geopolitical tensions in the region. In reality, however, far more importers are likely to experience the negative consequences of selecting an improper supplier than any of the previously mentioned risks. How then can importers ensure they are adding the right supplier to their supply-chain?

To definitely answer that question one would require a lengthy examination that extends far beyond the scope of this paper, but companies can *begin* solving this challenge by basing their supplier selection process on more robust qualification criteria that goes beyond simple pricing competitiveness alone. Why, though, is it important for businesses to look deeper into a prospective supplier when they offer comparable or even better pricing than previously available suppliers? Recent events suggest that when businesses remain too myopic in the supplier selection process, especially in low costs countries like China, they are exposed to increased supply-chain risks. Often, this correlation between price-centric supplier selection and a misalignment of supplier/customer interests only becomes apparent once there is a major disruption.

Increased Risk Due to Availability Heuristic and Price-Centric Decisions

Anyone who has ever researched or inquired into the availability of a Chinese supplier has no doubt come across the many B2B matchmaking websites and the thousands of trade shows across China. Perhaps, then, it is no surprise that leading e-commerce site, Alibaba, has 231 million active monthly users and the Canton Fair hosts tens of thousands of visitors, as more companies look to import from China.

Today, individuals can readily identify hundreds of purported manufacturers across China and contact their sales teams with the click of the mouse. As a result, the supplier selection process has become quicker, and in many cases, less extensive when a Procurement Director is able to communicate with a potential foreign supplier via email from the comfort of his desk.

But with these apparent improvements in the ability to connect with foreign trading partners, many US companies have been lulled into a sense of complacency by ignoring the various underlying risks these “turnkey” solutions present. As recently as 2011 for instance, serious allegations of fraud within Alibaba’s “gold supplier” network garnered international attention after investigators uncovered that a group of Alibaba sales personnel knowingly allowed the establishment of fictitious storefronts on their website to intentionally defraud foreign buyers.

Increased Risk Due to Availability Heuristic and Price-Centric Decisions (continued)

But while these claims clearly underscore the danger of relying on B2B matchmaking portals, few companies have re-examined their process of identifying and qualifying Chinese suppliers. In turn, organizations are exposing their companies to new risks, often with serious consequences.

For example, think of the company that wants to find a supplier for a consumer product sold in big box stores throughout the United States. Their Director of Procurement scoured the internet and found a pool of potential suppliers in an afternoon's work. After reviewing various suppliers' product offerings on their online catalogues, the Director of Procurement contacted those making like products and then submitted a request for pricing. With pricing information from multiple suppliers in hand, the company selected the second cheapest manufacturer based on the profit potential and the supplier's posted customer base, which included recognizable Fortune 500 companies.

After selecting this supplier, the Director of Procurement traveled to meet with the Chinese manufacturer's management team and upon returning, placed production orders after just one month since beginning their initial search for a new foreign supplier.

Initially, this US company received quality product, but after two months a major claim was filed, amounting to over \$100,000 for nonconforming goods. After dozens of emails and two visits to the supplier, it was determined that the supplier had been outsourcing those products, and due to the quoted price, the true manufacturer was unable to ensure quality.

At this point the US customer was faced with a difficult decision- assume the costs associated with recurring claims at the current price point, or accept a higher price to meet basic quality standards, thereby reducing the program's overall profitability. Ultimately, in order to protect their brand this US customer was forced to accept a higher price all but eliminating any profits from the overall program.

This case, while serious is far from rare and demonstrates how a company searching for a competitive advantage can quickly face real financial losses from poor supplier selection.

More Robust Qualification Criteria Can Correlate to Better Supplier Selection

Companies that view the addition of Chinese suppliers as a part of their larger procurement strategy often approach the supplier qualification and selection process in a far more systematic fashion than those simply looking to capture the low hanging fruit of labor arbitrage.

Time and again, companies who seek to find the proper fit for their supply-chain, and not just the lowest price supplier, receive benefits that far exceed the difference in price from the lowest quoting supplier. These benefits can include:

- Stronger, more collaborative supplier/customer relationships
- Lower claim rates
- Enhanced troubleshooting and crisis management

These tradeoffs validate the notion that the lowest price is not necessarily the greatest *value* for US customers. This broader, more strategic approach helps reduce risk by forcing a better understanding of a supplier's true capabilities, and, in essence, linking those capabilities with their pricing.

Creating a Systematic Vetting Processes

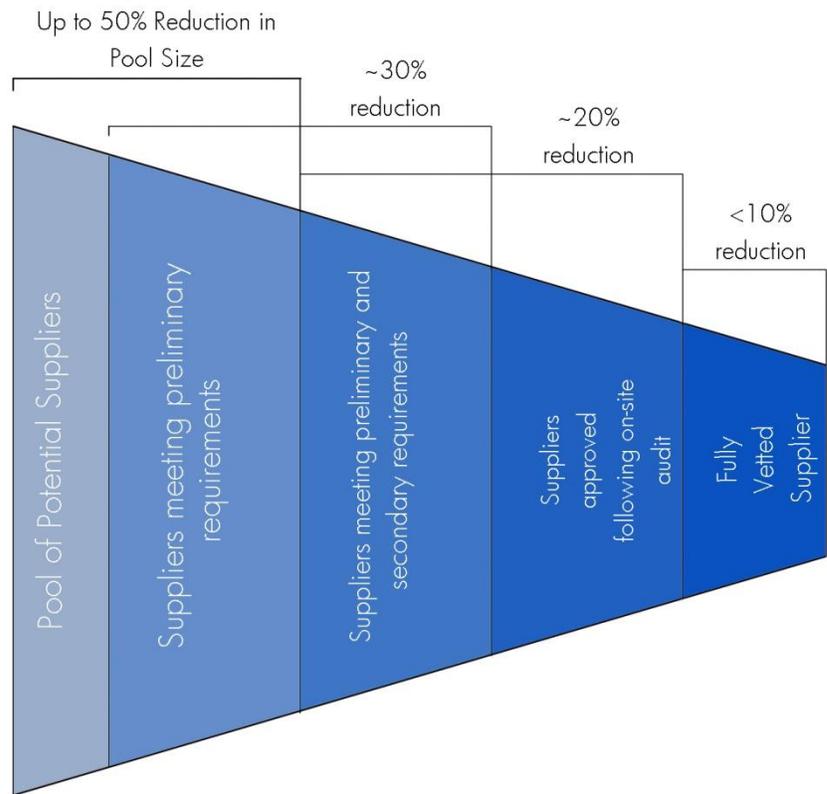
When qualifying a foreign supplier it is essential to pursue a clearly defined and systematic process to gather and analyze data regarding the supply-base for any given product. To achieve this, companies must first document their foreign supplier requirements.

These criteria can include ownership structure, financial stability, size, technical capabilities, and quality of management controls. When creating these standards, it is important to understand your needs relative to other businesses and customers in the marketplace. U.S. importers too often look for suppliers whose standards on paper far exceed their requirements, but are not necessarily the best fit due to misaligned interests between supplier and customer.

Once foreign supplier requirements are clearly documented, the process of qualifying potential candidates should follow a multi-tiered process. This progressively more stringent qualification procedure allows one to focus attention on increasingly higher quality candidates while reducing or eliminating contact with suppliers not suitable for inclusion in their supply-chain.

Creating a Systematic Vetting Processes
(continued)

Reduction of Candidate Pool by Process



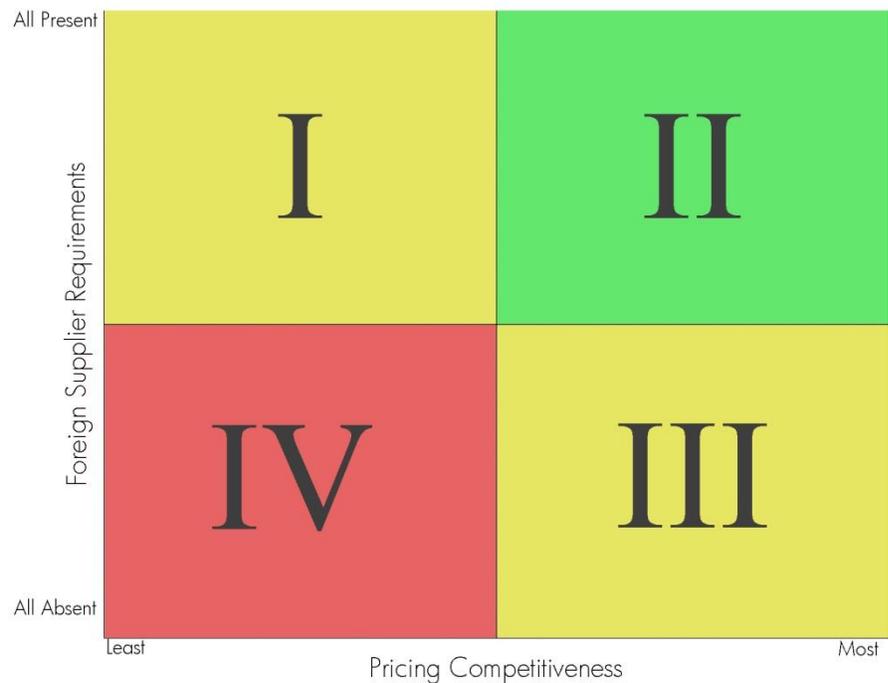
To begin this process, start with broad-based requirements to eliminate the poorest candidates. This initial vetting can consist of evaluating available capacity, technical certifications, and ownership structure. This preliminary vetting process commonly produces a response rate of <50%, and depending on methods used to identify the initial pool of candidates, it is not unreasonable to find that almost 30% of respondents fail to meet the most essential requirements.

Creating a Systematic Vetting Processes
(continued)

Having eliminated suppliers who fail to meet basic qualification standards, a more comprehensive secondary screening should be conducted. At this point, screening criteria should include specific business requirements, such as: pricing and payment terms, production lead times, and quality control management. Following this secondary vetting process, the pool of data will begin to show a small “best in class” group of suppliers (Quadrant II) and a large, group of second tier suppliers (Quadrants I & III.) Importers may still find a suitable trading partner within this larger pool of candidates, but further analysis is needed to make that determination.

To complete the vetting process, conduct an in-person audit of all suppliers believed to be a valuable addition to your supply-chain.

Supplier Qualification Matrix



Analyzing this data

With hundreds of data points from dozens of potential suppliers, it is easy to get lost. When analyzing data collected during the supplier qualification process, there are two primary sets of data. The first is based on the criteria your company has specifically outlined as required in a potential supplier.

The second set of data is external or market driven. This data can include cost of labor, availability of raw material, proximity to vital transportation hubs and even industry trends. It is this secondary set of data that can easily turn a favorable supplier into an unfavorable supplier, but recognizing the impact of these mitigating factors is crucial to the selection process. When accounting for these secondary data points, it is important to recognize the following:

Causation of Data: This connectivity can be beneficial such as in the case of requiring a supplier to have certain certifications which may mean higher quality of work; or negative such as limited production capabilities and higher prices due to inefficiency. Regardless of the impact, it is important to understand which factors affect the values sought in your most basic supplier requirements.

Forward looking Data: It is common for Chinese suppliers to be in the process of gaining new industry certifications or making capital improvements. In turn, data collected and analyzed may suggest current conditions are favorable, such as available production space, or unfavorable, such as missing certifications, but this data must be examined in a broader, forward-looking, context that takes into account market changes and larger trends.

Prioritization of Data: Not all input values are the same. When evaluating any data point, it is valuable to create a weighted classification function that discriminates between essential and non-essential criteria. This will allow each supplier to receive a holistic grade allowing easier differentiation among potential suppliers.

Seeing the Big Picture

With a more robust and comprehensive understanding of the supplier landscape in China, business leaders are able to make more informed decisions. Take, for example, one of the nation's largest sliver knitters who investigated the possibility of expanding their raw material supply-chain into China.

Facing a constricting domestic raw material supply-base, this sliver knitter needed to explore opportunities to reduce supplier dependency and minimize production bottlenecks resulting from raw material shortages. After evaluating many potential solutions, their CEO decided to consider adding Chinese raw material suppliers to their supply-chain.

Understanding that their needs extended beyond simply finding a low cost supplier for raw material, and that product development, export experience, and a strong management team were essential in a new trading partner, this company approached the supplier selection process from a holistic standpoint.

After identifying a pool of nearly fifty potential suppliers, this company pursued a three-tiered qualification program, including more than three dozen grading criteria. After three months of data collection and analysis, this company was able to add two new raw material suppliers to their supply-chain and, in turn, eliminate production bottlenecks and reduce supplier dependency.

By focusing on multiple criteria and looking beyond pricing, this company found suppliers that were also willing to collaborate on product development and were eager to resolve claims when they arose, as the supplier viewed this company more as a trading partner than just another customer.

Applying These Principles to Existing Suppliers

Supplier qualification is not a singular event that simply precedes adding a new supplier to a company's supply-chain. Rather supplier qualification is an on-going process that requires performance benchmarking, routine analysis, and investing in the future. While many companies are using suppliers that are not fully qualified, but are performing to an acceptable degree, it is prudent to proactively re-qualify existing suppliers where data is absent or over a year old.

These re-audits should include reviews of a supplier's historical performance, existing and future technical capabilities, management team, long-term business plans, and financial standing. Once these re-audits have been completed, it is astounding how many importers uncover previously unknown supplier capabilities or, in some cases, hidden risks such as suppliers positioning to become future competitors.

Strength and Resiliency from Information

There is no doubt that procurement directors and managers have more tools than ever before to identify potential trading partners across the globe. While these new methods open previously untapped possibilities for businesses active on the global playing field, the risks associated with adding suppliers that have not been fully vetted far outweigh the potential rewards.

To reduce this risk and increase the likelihood of finding a supplier that provides substantive and lasting value, instead of simple labor arbitrage, companies must look beyond pricing competitiveness. Those that are able to adopt a culture that views the supplier selection process as a strategic decision rather than a means to fill orders will soon find themselves gaining market share from less in-tune competitors.

To learn more about supplier identification and qualification solutions in China, visit:

www.theabcgroupllc.com/supplier-landscape-analysis.html

theabcgroupllc.com

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