White Paper

A source of satisfaction: Technology support for global sourcing

Introduction

Up until the 1970s, most fashion brand owners were also product manufacturers. They controlled the fashion industry with an iron fist, dominating the supply chain all the way through to the retailer. As

the 70s went on, the market was flooded by an explosion of new designer labels. For these upstart designer brands, the biggest challenge was finding a way to turn their ideas into products without yielding to the more traditional fashion manufacturers and their control of the industry. They did this by finding subcontractors to outsource to who did not have an established relationship with a particular brand, but did have the necessary skills. At first, most outsourcing sites were in the same country, and in many cases in the same city, as their clients. However, as time went on this practice expanded to countries such as Japan, Taiwan, and Korea.

In the early 1980s, China emerged as the new hotspot for manufacturing. China's capacity created a fast-growing resource pool for manufacturing without the usual brand connections. In order to keep up with the new designer labels—companies not burdened by the usual overheads tied to an aging manufacturing facility—brand owner/manufacturers began to use manufacturers without existing brand connections. As demand grew, so too did capacity.

Fuelled by significant investment, subcontractors soon became more skilled in fashion production than the former brand-owning manufacturers, who could no longer control the supply to retail chain. In fact, now anyone could get or source anything from anywhere.

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From manufacturing to sourcing

Over the past couple of decades, most apparel and footwear brands in developed economies have moved away from their manufacturing origins. Supported by information technology, they have evolved into sourcing companies whose manufacturing is handled by a third party. The manufacturer is often located in countries with available labor, modern plants and equipment, and a lower cost base. For example, companies tend to source in Asia, Central America and the Caribbean, while European companies typically opt for Asia and Eastern Europe.

However, as costs rise across a region, companies that outsource must first look for and then shift their business to new destinations with the requisite conditions. Often their former suppliers start to develop their own brands, outsourcing in their turn to emerging lower-cost economies. And so the cycle continues. Competition is driven increasingly by information technology, as more manufacturers in lowercost economies embrace technology in order to better control their costs. The players may change positions, but the search for cost/margin parity and competitive advantage never stops.

Two sourcing models

Outsourcing comes with a number of challenges. Geographic distances lengthen lead times and increase inventory requirements. Time zones, language barriers, and cultural differences can add to the complexity of communicating with suppliers and managing the supply chain. As new markets evolve, the search for new low-cost manufacturing destinations continues. Though harder to establish and maintain, a good relationship with a supplier is even more important at this stage. Shorter product lifecycles increase the need for collaborative product development and better visibility into orders and inventory in the supply chain. The same is true when it comes to “fast fashion,” which generates more, but smaller order commitments.

To remain profitable when facing such challenges, a company sourcing goods must do more than negotiate a good price with suppliers. It must plan and continuously monitor the path ahead as well as keep an eye on costs. Hidden costs such as delays and quality control issues, the need for emergency air freighting, customs delays, import/export duties, and fluctuating exchange rates may erode the buyer’s expected profit margins. To protect margins and reduce markdowns in the compressed time frame available, buyers must rely on information from their business systems. This information will tell them who to source from with the lowest risk and how to calculate costs accurately in order to maximize profitability.

Sourcing as a process is unique to every company that does it; the process is a reflection of a company’s values and business model. How a company approaches sourcing can make a lot of difference to the results they experience. There are essentially two sourcing models: One is strategic and relationship-driven; the other is a more opportunistic, cost-driven approach.

Strategic vs. opportunistic sourcing

The timeline for a strategic plan is typically three years minimum and generally not more than seven. If a company with a strategic approach plans to source goods from a particular region on a regular basis it often invests in building long-term relationships and a proper supplier base. Supplier performance analysis is key to strategic sourcing. However, companies with a more opportunistic approach have a much shorter perspective, and focus on the immediate opportunity to be gained in a particular deal. For these companies, the key aspect to supplier selection is competitive bidding, basically an auction of goods or services. Purely cost-driven outsourcing tends to become even more opportunistic during an economic slowdown, during which little attention is paid to quality. Delivery at 'a cost' is the overriding issue.

While the differences between the two approaches are evident in planning and costing, the acid test for both is quality control. As time goes on, the impact of quality control on the total cost of sourcing separates the two models more and more. As Figure 1 shows, companies with a strategic approach may start out paying more for sourcing than those with a cost-driven or opportunistic approach. This is because companies that use the opportunistic approach always look for the lowest price available.

However, strategically-oriented companies drive down their sourcing costs over time by investing in long-tem relationships. This promotes higher quality at a lower cost. In the long run this approach enables these companies to pay substantially less for sourcing than their opportunistic competitors.

"You get to a point with strategic sourcing where you've developed the right operating models, the right methodology, to a point where you have consistent quality delivered season after season, year after year. You no longer have to invest heavily in your QA (quality assurance) checks from that particular source," says Bob McKee, Industry Strategy Director, Infor™ Fashion.

By contrast, he says, "In the world of opportunistic sourcing, you end up having to spend a tremendous amount on quality-related follow-up and follow-through. Without this degree of diligence, 8% or more of the goods ordered can't be sold because of poor quality, short shipments, or mislabeling. While you may have all kinds of stopgaps built into your systems that keep you from having to take ownership, the cost to your organization can still be substantial. As a result, this type of sourcing takes greater cash investment, even though the per-item price as quoted may be substantially lower. Once you factor quality into it, the cheap source is not always as cheap as expected."

The risks and benefits of outsourcing

Garment manufacture is a labor-intensive process and labor costs can account for up to 60% of production costs (Gereffi, 2003). Also, the labor-intensive nature of this type of manufacturing process means that the typical apparel supply chain is now characterized by globally dispersed production networks. The sewing process usually accounts for 30% of a garment's cost. Outsourcing production to lower-cost destinations enables companies to make significant savings in terms of supply chain costs, freeing up essential capital. With more funds available brand owners can focus on and enhance the core capabilities that can drive their competitive advantage. By concentrating on the design and marketing of the brand, as well as focusing on its retail outlets, they can see an increase in their overall brand value.

However, despite the potential benefits of outsourcing production to lower-cost countries, there are also risks involved. For many companies, the business model is evolving. Many brands are now regarded as manufacturers without factories. This places a new set of requirements on the brand, as well as creates the potential for hidden costs. Over the last few years, several studies have shown that about half of all North American and European companies that shift business processes offshore fail to generate the expected financial benefits (Aron and Singh, 2005). The harsh reality of outsourcing is that cost reduction, increased efficiency, and strategic advantage will not result unless the decision to outsource is made systematically. By making outsourcing decisions on a piecemeal basis, based merely on overhead cost savings, companies may fail to capitalize on the full range of opportunities to be gained. Furthermore, as low-cost sourcing opportunities become exhausted and sourcing price deflation tails off, there is pressure on brands to adopt a broader outsourcing strategy that will generate sustainable benefits over and above cost reduction.

When sourcing globally from low labor cost countries, the supply base holds significant challenges that must be overcome in order to deliver customer service for end consumers. Additional challenges associated with the international business setting are centered on cultural, political and legal differences, and the increased geographical length of the supply chain. Cho and Kang (2001) list several challenges and risks of global apparel sourcing. These include everything from transportation delays, to lack of technology and proper inventory management systems, fluctuating exchange rates, trade regulations, and the political and economic stability of the location.

It's often difficult for companies looking to outsource to foresee hidden costs. These costs can cancel out the benefits of sourcing from low labor cost suppliers. On the surface the effect may appear small, but in reality their impact could be significant.

Total cost of sourcing

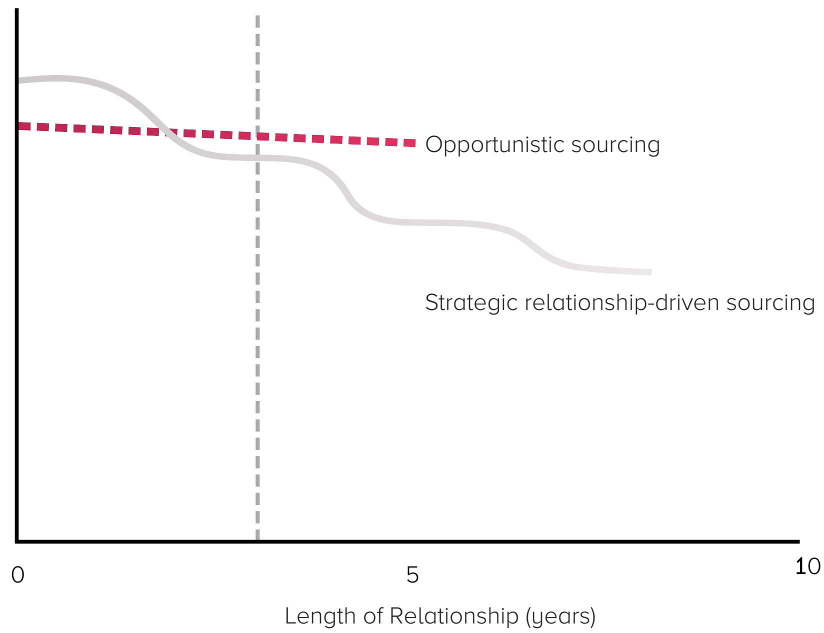

Figure 1. Sourcing costs over time for different sourcing strategies. Unit cost of sourcing may always be higher for strategic relationship driven sourcing; however, the total cost of a sourced product delivered to the customer can be significantly lower.

Too complicated for spreadsheets

Companies with a strategic orientation are naturally inclined to seek out best practices to maximize the advantages of working in a closely-knit sourcing environment. For these companies, ongoing supplier performance analysis is a core best practice in itself. However, many smaller companies just want to know if a particular supplier consistently delivers the agreed quantity, on time, and at an acceptable level of quality. They can document this manually and store the results in a spreadsheet. But what if you want to identify and compare suppliers' performance? What if you need to know whether their capacity, capabilities, and documented regulatory compliance are suitable for the product you want to source? You need to keep shipping costs and lead times down. How will you find a supplier who's in the same region as you are? The answer to all of these questions can be summed up in a single word: database. You need a database to store all of this information and analyses. A spreadsheet would, quite simply, be too complicated to maintain or search.

A database might also allow you to define the relationship that suppliers have with one another and address entire supply networks. For example, one supplier works with certain agents who have exclusive relationships with certain factories, while another supplier works with different mills or trim suppliers. Your designers may want to use a new fabric from a certain mill. Does your usual supplier have a relationship with that mill? Can you approach them directly? Who should receive the request for quote (RFQ)? Does the same person receive the purchase order (PO)? The more complex the supply chain becomes, the newer you are to the region, or the less time you can afford to spend on searching, the more valuable the database becomes.

Using IT to outsource

As supply chains become more global and manufacturing sites further away from the point of sale, companies are beginning to see the value of using information technology to manage their outsourcing arrangements. IT systems enable the exchange of information across functional, geographical, and time barriers. Enhanced communication technologies facilitate innovation and allow information to be shared and available to decision makers in different parts of the world. With instant access to real-time information, IT can help decision making become faster and more efficient. IT systems enhance the collaboration between supply chain partners by facilitating communication, as well as the sharing of knowledge and experience. Better communication and collaboration in their turn help to develop the long-term relationships that are the foundation of supply chain agility and fast fashion strategies. Agility is particularly important in the apparel industry. Without agility companies cannot react to the unpredictability that characterizes the industry or see that the right product gets to the right place at the right time.

Agility also means being able to quickly cancel product lines that aren't selling. It's the ability to reduce the level of markdowns and operate with small stockrooms, thus reducing inventory holding costs. With real-time information regarding actual consumer demand, an IT system enables brand owners to coordinate the processes of forecasting, production scheduling, inventory management and distribution. In the end what it comes down to is this: The adoption of quick response, just-in-time (JIT) systems and warehouse management systems facilitated by IT can help apparel companies to manage and overcome the major obstacles in global apparel sourcing.

Key business processes in sourcing

Recently, sourcing application suites have gained prominence as a way to deal with the challenges of global sourcing, such as supplier evaluation, product lifecycle management, and in-bound logistics. In addition, key business processes such as costing and profitability analysis, product development and communication of specifications, and quotation management that were formerly manual and local have also been automated and put online. This is to overcome the constraints of distance, language differences, a lengthening supply chain, and shortening cycle time. Figure 2 shows where these processes fit in an end-to-end business process management solution.

End-to-end business process matrix

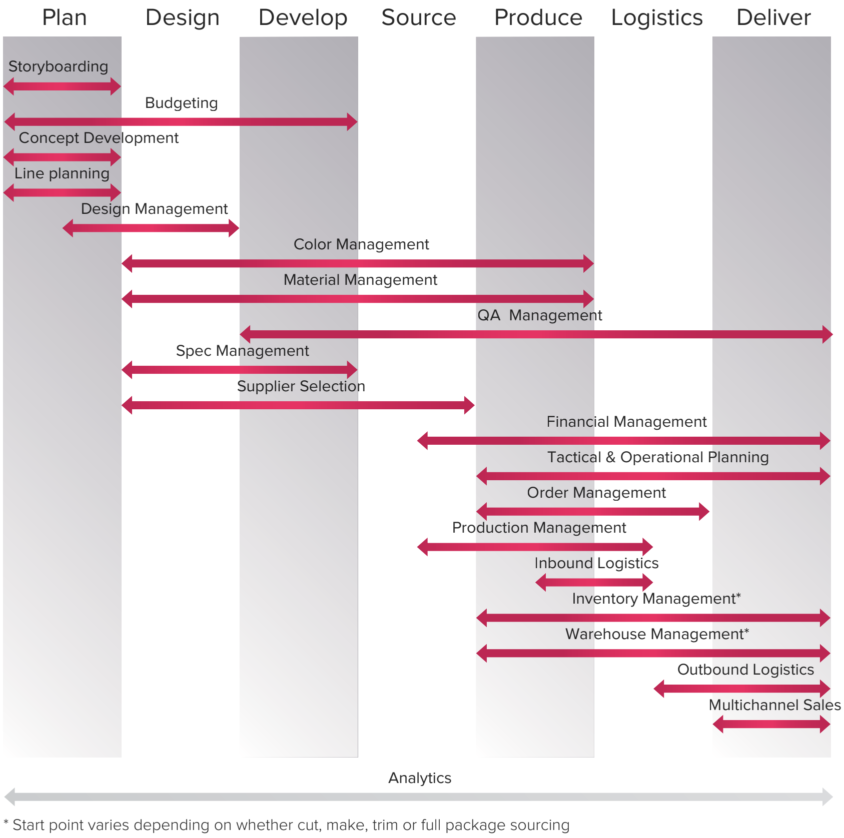

Figure 2. Main business processes for a fashion sourcing company.

Costing and profitability analysis

In some sourcing applications, a buyer can run what-if scenarios as the collection is being costed and quotes come in from multiple suppliers. By modeling potential use of the quotes received, the buyer can see how they calculate out as a group and what the cost trade-offs are. For example, if bids for a particular style are coming in high, how is that going to impact the bottom line for the entire collection? Can you afford that style at the higher price if you buy a different style at a lower price? Together do they give you the margins you need for the entire collection? What happens when transportation costs are added? By selecting shipment options—airfreight versus sea cargo, slow boat versus fast boat—in the actual cost quote, you can recalculate the entire landed cost and calculate all the way up to the margins and the sale price. The potential to make better decisions at an earlier stage is clear.

At other times, you may be trying to resolve a speed versus cost trade-off. For example, you may have received a number of quotes, some of which are based on sea shipment, others on airfreight. You do cost comparisons between them prior to placing an initial order and select the shipping option. Later the style really takes off in the stores and you need to resupply quickly. You can pull up the quote from a supplier that included airfreight charges, contact them through the system, ask them to review the specifications transmitted online, and place the order. Or perhaps you have a split sourcing strategy: all initial orders are sourced from a low-cost country and shipped in, but any replenishment order comes from a more expensive but geographically closer factory. Quicker delivery allows you to take advantage of immediate consumer demand.

Overlapping IT systems

Various software categories, previously distinct, are beginning to overlap and merge. Standalone sourcing applications are beginning to merge with product lifecycle management (PLM) systems while both are beginning to merge with ERP systems for an end-to-end enterprise management solution. The main driving force behind this is the need to streamline processes. The impact on product development can be transformative. “Choosing one vendor for both your PLM and sourcing needs can greatly reduce the risk involved, as well as cut implementation time too,” says Anne Mullins, Solution Consultant for Fashion at Infor. “What’s more, a single, consistent user interface helps to ensure a better overall user experience.”

Traditionally, designers finish concept sketches and then turn them over to technical designers who first transform them into samples and then into a spec package that the sourcing manager passes to the various suppliers for bidding. The supplier who offers the best price gets the job. Now this sequential process can incorporate elements of collaboration, simultaneity, and interactivity that were not possible before. You can develop a style over the web, with input from both in-house and supplier teams and make it available to everyone at the same time. You can put as much design effort as you want into making products that mesh with your suppliers’ core competences. Since most of the available time and cost savings have already been wrung out of production, the vast majority of future reductions in time-to-market will come from improvements in communication and collaboration during the development phase.

For example, using an electronic storyboard, the creative design team can share a concept with technical designers, buyers, and selected suppliers simultaneously. Product specification is directly associated with live costing and sourcing data. When a costing scenario is created whether from internal data stored from past product sourcing or from supplier quotes it is associated to a point in time and copied to the bill of materials (BOM). If the BOM is changed later, the change is automatically flagged. The buyer can instantly see a change that the designer makes, compare it to the previous version, and either accept or reject it. When a supplier gets a request for quotation (RFQ) by e-mail, it contains a link to the design. Information about quantity, delivery date, and specs—BOM, construction, and points of measure—are all at their fingertips, so they have all the data that they need to cost in one place. Either party can attach any related documents not just to the RFQ, but to the quote itself.

Enterprise management solution

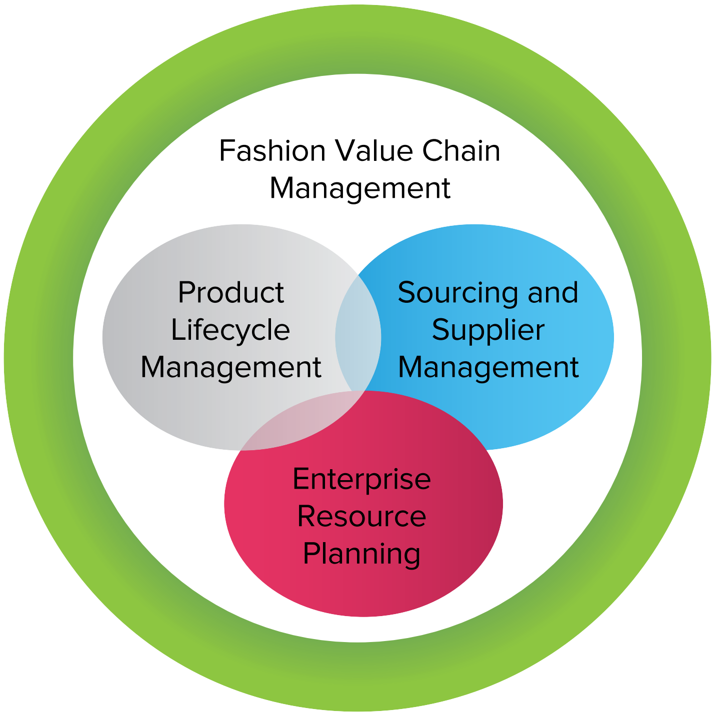

Figure 3. Enterprise solutions for fashion value chain management.

Quotation management

The base functionality of a sourcing application should include the ability to publish requests and enable suppliers to submit bids/responses online. In some systems, bidders can upload a document rather than fill out a form, but this is not a best practice. Unless bidders use a form linked to a central database, you are not going to receive standardized data to report against and query consistently. In some applications, suppliers can offer substitutions on a component and submit them for approval. If the substitutions are written to the BOM in the central database, you still receive standardized data.

Bid evaluation is one of the most crucial sourcing processes. Performed manually, it is also one of the most time-consuming and tedious. When automated, it provides big-picture visualization at every level. The buyer can compare bids on each individual style and/or roll them up to see total spending, margins, and quantities projected. All this data is available to do what-if costing scenarios or to summarize what has been bought so far. Reporting capabilities provide drill-down detail: for example, all the quotes received on a particular style, or just the approved quotes per style, or all detailed costing information side by side for comparison.

Since bid evaluation must frequently be suspended until all bids are in, it is extremely useful to give the buyer a way to record interim judgments (e.g., mark as reviewed, keep open and viable, approve, or reject) and to set or change the status of a bid depending on whether the buyer intends to negotiate further. That status note is then available for reporting purposes and to roll up into the actual market and spending analysis in the sourcing plan.

The quotation management process ends with the creation of a purchase order. The sourcing application may have the ability to generate the PO for the initial order, and some also track it through all the subsequent phases of production, quality assurance, distribution, and delivery. In rare examples, the system even has the ability to automatically generate replenishment orders.

Sourcing: the complete picture

Sourcing is not the same as shopping. It does not end when you buy something. In the fashion and apparel industry, sourcing is about the whole relationship between the customer and the supplier. Managing that relationship bilaterally is crucial for the longterm success of both parties. A fashion company that has good working relationships with suppliers usually has a small number of suppliers and long-standing relationships.

Most sourcing applications focus solely on preproduction issues: getting agreement on what to produce, where to produce it, and what it will cost. During the preproduction phase and in the early days of taking orders, work is based on these plans. During the life of the product, you want to be able to work based on what is actually happening in the supply chain. The ability to monitor the outcome of sourcing decisions provides the complete picture of sourcing as a replicable, improvable process.

In order for sourcing not to be a shot in the dark, supplier evaluation is an essential part of any sourcing application. Supplier performance can be defined in a number of ways, from on-time delivery to accuracy of invoicing, but of course, performance occurs after the purchase order is generated. Ideally, then, all the data points of the evaluation can be related not only to the technical specifications and the BOM, but also to the purchase order and financial reconciliation to help guide supplier selection in the future.

If that data collection occurs, it is also available to enable operational analyses that are central to managing profitably. As suppliers confirm back actual delivery dates and quantities (and at a later stage, what they are actually sending in shipments), can you see what impact any changes from plan will have on your ability to service your own customers? Do you have visibility across the supply chain, starting from customer demand, going to where the inventory is in your supply chain? Do you have the visibility to see what you’re actually selling to customers against forecast?

Can you tell where cost variances came from? Where logistical bottlenecks came from—and how they can be avoided? A transactional system that can answer these questions, combined with the planning and management capabilities discussed earlier, can give you the complete picture.

Sourcing almost always involves transactions in multiple currencies. It is essential, therefore, to have multi-language/multi-currency support in your business system. Another valuable feature is the ability to manage letters of credit and to pay invoices from them, thereby making it easier to deal with fluctuating currency values. By analyzing this data, you can see where your cost has changed as result of exchange rate fluctuations.

How IT supports sourcing

A good IT system can cover the entire sourcing cycle from preproduction design and development issues, to generating and monitoring orders, through to order fulfillment and evaluation of supplier performance. At the preproduction stage, it can support what-if costing scenarios, quotation management, and sample/test management. An IT system can enable collaborative product development and improve communication internally, as well as up and down the supply chain. These and other capabilities lead to shorter lead times and time-to-market while keeping tight control on costs. When looking for an IT system make sure it has the functionality to manage demand planning, costing, and forecasting of sourcing, and then, based on the forecast and agreements with suppliers, the ability to automatically generate POs. As the supplier confirms back the actual delivery date, quantity, shipments, etc., the sourcing manager can monitor and see the impact of any change.

“Increasingly, companies are beginning to realize that to optimize performance they need their PLM and sourcing strategy to be tightly integrated with their enterprise management system,” says Madeleine v Dijk, Product Manager for Fashion at Infor. The main advantages of tighter integration between PLM and sourcing solutions are faster time-to-market, enhanced visibility across the entire supply chain, and tighter control on costs throughout the process. Businesses will also become more agile, which means they can react faster to changes in consumer demand. The right IT platform can help realize these potential benefits.

Technological developments such as PLM, SCM (supply chain management) and collaboration systems facilitate the development of close relationships between geographically distant supply chain members. They can help to maximize visibility across complex global supply chains. The sharing of real-time information enables brands to respond faster to trends, which maximizes the potential for full-price sales. Analytic technologies improve the quality and speed of information that is needed to support responsive decision-making.

In turn, the strategy of quick response is supported; quick response aims to increase competitiveness via improvements in collaborative and technological capabilities. IT facilitates agility in the supply chain to enable garments to move more rapidly through the supply chain and reduce time-to-market. Integrated business applications automate transactions and facilitate collaboration between supply chain partners to reduce lead times, inventories, and operating costs.

Conclusions

In the end, the real synergies of outsourcing can be found in IT systems and long-term relationships within the supply chain. Strategic outsourcing relationships build long-term value and result from the brand working in partnership with a limited number of best-in-class suppliers for mutual benefit. Sharing information and collaborating to achieve the best possible mutual performance maximizes the potential for fully reaping the rewards of outsourcing. However, a well-defined strategy is crucial in order to harness the benefits of outsourcing while avoiding its pitfalls. IT facilitates information sharing, collaboration and the development of strong relationships which is the foundation of strategic outsourcing.

Strategic outsourcing recognizes the broader organizational implications of outsourcing rather than solely focusing on the financial aspect in terms of labor-cost savings. By harnessing IT to facilitate the development of strong collaborative partnerships across the global supply chain, strategic outsourcing seeks to improve supply chain agility, responsiveness, and accuracy of getting products to market. The potential benefits of outsourcing when undertaken within a well-defined broader organizational strategy are therefore superior as they stretch beyond cost reduction to generating profit and gaining and sustaining competitive advantage. Companies wishing to pursue strategic outsourcing should first review their business processes and identify potential opportunities as well as the potential hidden costs. Then, they should evaluate how process change and/or technology can help exploit the benefits from potential opportunities. Finally, they must quantify those opportunities in financial terms and the potential return on investment.

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