

From Low-Cost Country Sourcing to “Profitable Proximity Sourcing?”

IDC’s Simon Ellis Says Companies Know They Should Look at Total Supply Chain Costs, but Many Don’t

SCDigest Editorial Staff

Too many companies wind up sourcing products from low-cost countries based on direct per unit costs and not total supply chain costs, says a leading researcher from IDC’s Manufacturing Insights group. While that critique has been around for a long while, IDC’s **Simon Ellis** wraps that observation up in an intriguing conceptual framework – “Profitable Proximity Sourcing” – that is definitely worth keeping in mind when making global sourcing decisions.

In a recent research note, Ellis comments that “While low cost manufacturing is seductive initially, a “total supply chain cost” perspective is far more sensible - particularly as distribution costs grow as a percentage of total cost. Looking at total cost is hardly a new concept, yet all too often businesses do not take this view and end up sourcing sub-optimally.”

In an even more bold observation, Ellis – formerly a “supply chain futurist” with Unilever North America before joining Manufacturing Insights – says that he believes that “the current myopic pursuit of “low cost country sourcing” as a primary cost mitigation strategy is coming to an end,” in part as companies better understand total supply chain costs and as they focus on achieving a better balance of cost and service trade-offs.

Profitable Proximity Sourcing

In place of “low cost country sourcing,” Ellis offers instead the concept of “profitable proximity sourcing” (PPS).

What does that mean? Ellis says it is “an intriguing concept that looks to balance cost and service, with

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going Green or sustainability also increasingly playing a role in the decision-making process.” He adds that PPS is not meant to dissuade companies from low-cost country sourcing, but rather to “encourage it as part of a diversified sourcing portfolio.”

Ellis says he sees examples of this in action currently in the apparel industry, where many companies use Asian countries to make more mature, stable products but choose closer sourcing locations, such as Central America, for newer, fashion SKUs, accepting higher unit costs to gain speed and flexibility. This allows “the supply network to act more quickly to the more unpredictable nature of the demand.”

Of course, driving the PPS concept in part was undoubtedly the rapid rise in oil prices and transportation costs over the last few years. In just the past few weeks, however, those oil prices have dropped precipitously from mid-2008 highs, but are still near what seemed to be very elevated levels in 2007. Many expect oil prices to begin climbing again after a few quarters, or maybe sooner.

From Low-Cost Country Sourcing to "Profitable Proximity Sourcing?" (Con't)

Ellis' main point is that a more nuanced approach to sourcing decisions is required that achieves a dynamic portfolio of sourcing strategies, based on factors such as inherent product-market characteristics, where a given SKU is in its product lifecycle, market strategies, and other factors.

Key to these choices is also the existing balance between manufacturing and logistics/distribution costs, which can vary dramatically by industry and product. Green/sustainability factors may now introduce new variables that could make even "total supply chain costs" an incomplete measure.

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ing, and demand/supply balanced sourcing to provide a globally distributed supply network that best meets business objectives for cost and service."

SCDigest comment: The challenge, of course, is be able to understand yet alone balance all these variables. Companies will look to technology to play a role in "computing" the various trade-offs among cost, lead-time and flexibility, with Green a simply unknown factor at this point.

