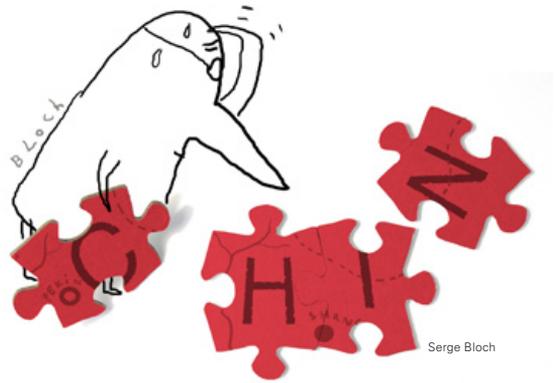


The challenges in Chinese procurement



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Companies that source goods from China must overcome several challenges to realize the opportunity in full.

US companies have captured only a fraction of China’s potential as a source of low-cost products and plan to strengthen their purchasing activities in the country, despite high employee turnover and other difficulties. In a survey of 39 US companies with sourcing offices in China,¹ the respondents estimated that these companies buy only 30 percent of the

goods they ultimately could buy there, though that figure will rise to 50 percent three years from now. Moreover, to date, the respondents’ companies have captured only about one-quarter of the potential savings from purchasing in China—a proportion expected to hit 40 percent in three years. (Volumes increase faster than savings because it

EXHIBIT I

More manageable in time

Survey group’s average rating

Which issues in a sourcing organization in China are the most difficult to tackle?



Source: 2005 McKinsey–American Chamber of Commerce (Shanghai) survey of 39 US companies with sourcing offices in China

EXHIBIT 2

Trailing behind?

Survey group's average rating

How does your company's performance compare with that of its competitors?



Source: 2005 McKinsey–American Chamber of Commerce (Shanghai) survey of 39 US companies with sourcing offices in China

takes time for suppliers to squeeze out costs.) Notwithstanding all the press about Chinese exports to the West, only a fraction of the full potential has been captured so far.

Companies maintain that they are overcoming many of the cultural and logistical complexities that vex them. Some of the issues (such as communicating with corporate headquarters, training Chinese workers, and overcoming cultural and language barriers) are expected to be less pressing three years from now as companies gain experience and streamline their purchasing processes (Exhibit 1). However, companies expect that today's number-one challenge—retaining workers in their Chinese offices—will get tougher, in view of high demand for experienced

people as multinationals expand their sourcing activities.

Despite the progress the respondents cite, companies worry that their procurement performance lags behind that of competitors. When we asked respondents how their companies compare with rivals in nine areas, from the total volume of goods purchased in China to the ability to develop a local workforce there, they felt that their employers trailed the competition on every point (Exhibit 2). They feel least secure about the size of the cost reductions they realize by sourcing products in China but also express concern about the quality of the products they buy and the slow pace at which volumes are increasing. Such concerns may reflect an awareness of the competitive challenge companies face in

China and of how much improvement is possible.

To increase the savings, companies are shifting their Chinese purchasing organizations into a higher gear. Although respondents indicate that reducing the cost of the goods their companies buy will remain a significant issue, raising volumes—in part by giving Chinese sourcing offices more autonomy and responsibility—will become increasingly important. Companies plan to transfer to China some critical functions and decisions that are currently the responsibility of headquarters. Although today just 14 percent of all companies in China design products there, our respondents believe that the proportion will rise to 50 percent in three years. Likewise, while 34 percent of the respondents say that their companies’ Chinese offices currently approve product prototypes, the proportion is expected to double in three years (Exhibit 3).

Companies expect that moving decisions overseas will yield competitive advantages, such as shortening the time needed to bring products to market. One European apparel manufacturer, for example, formerly needed 12 to 24 weeks to get

new products from the design phase to the point when it could place orders with its suppliers. By cutting the back-and-forth between headquarters and the Chinese sourcing office, the company has already shaved that time by several weeks and ultimately expects to reduce it to 5 to 10 weeks—though progress toward that goal has been slowed by a shortage of experienced staff in China and by opposition at headquarters to the change.

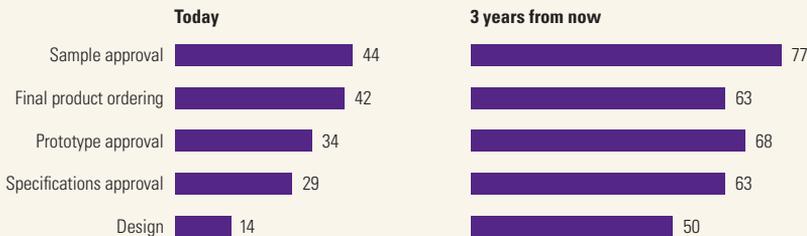
Indeed, despite the potential rewards of shifting more responsibility to China, companies often encounter resistance back home, especially if the procurement process traditionally has been centralized at headquarters. A prerequisite for giving an office in China more authority—and for raising the volume of goods purchased there—is the ability to instill greater confidence about Chinese staffers, suppliers, and products among the company’s internal customers, many of whom prefer to buy from familiar suppliers. Respondents say that their companies overcome such resistance in several ways: for instance, by inviting headquarters staff to China for frequent visits, by sending key Chinese employees to headquarters on job rota-

EXHIBIT 3

Sourcing functions will move to China

% of respondents

Which of the following functions do/will you perform in your sourcing of ce in China?



Source: 2005 McKinsey survey of 39 US companies with sourcing offices in China

