

## HOW TO BUY IN ASIA

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Southeast Asia is recognized today as the world's leading producer of a wide range of attractively priced electronic, electromechanical, and mechanical components, assemblies and finished products. Over the past twenty-five years, Asian sourcing has developed into a vital cost-reduction strategy for countless western high-tech companies. Moreover, an effective Far East sourcing strategy can significantly strengthen your company's strategic position in today's highly competitive world markets.

But what will be the best way for your company to go about purchasing Far East materials to ensure not only the lowest possible cost of ownership, but exposure to the lowest possible risks, especially in consideration of the vast distances, and language and cultural barriers involved? This paper discusses the various options available to Western companies for purchasing in the Far East. The options will be presented, each with its associated advantages and disadvantages, with particular attention to potential cost savings and the associated risks involved.

For certain, and often by a very wide margin, the lowest attainable prices for Asian-made components and assemblies can be obtained by purchasing directly from the Asian producers on an FOB Far East country-of-origin basis. There are many reasons contributing to this condition but perhaps the main reason is simply because of the fierce competition that has always existed amongst Asian producers in the Far East. In Asia, each manufacturer is competing with dozens, or perhaps hundreds of other producers and there is a strong tendency among the Asian manufacturers to quote very aggressively for business. In contrast, purchasing Asia-made goods in your own country, through local importers, distributors, or agents of Far East producers, will invariably lead to substantial erosion of the true potential cost savings, simply because these domestic sellers will be inclined to quote the highest prices possible based on the local competition at hand, which will be predominantly based on prices offered by domestic producers. So to obtain the lowest prices, you will need to develop the means to purchase directly from the Asian factories, in the Far East.

But before getting too far ahead of myself, let's look briefly at the various ways that Western companies can go about purchasing low-cost Asian materials, with particular focus on the risks versus the rewards for each approach.

The following table contains in summary form, the optional ways that a western company might choose to go about purchasing in the Far East:

- I. Establish your own company-owned IPO or IPO network in the Far East
- II. Purchase Asian goods 'at home' through sales agents or domestic offices of Asian suppliers
- III. Purchase in Asia on a direct basis from your domestic home office
- IV. Enlist the services of a professional, independent IPO organization.

## I. Establish your own company-owned IPO or IPO network in the Far East

If your actual or anticipated purchasing volume in the Far East will be reasonably large (say, at least \$10M at your company's standard cost over the first year) then one option that could be considered is to open your own International Purchasing Office (IPO) in Asia, or better yet, a network of them, depending on the countries where your key Asian supplier base will be located and the anticipated purchasing budget. The potential advantages of operating your own Asian purchasing office(s) include ultimately the greatest degree of control, and over the long term, low risk factors. But unfortunately, establishing your own IPO network in the Far East is extremely expensive (i.e. the most expensive alternative), has a very long learning curve (time required to decide in which countries to locate; securing office space and registration; staffing and training; qualifying suppliers, etc) and is the most complex solution to the problem (language, cultural and labor law issues; government laws and regulations; taxes and foreign exchange laws; qualification and development of the supplier base; technical and quality issues and needs); and requires very diverse staffing (mechanical, electrical and chemical engineers, quality, administrative, logistical and business personnel).

As a general guideline, on the average a Western company purchasing components and assemblies in the Far East today can realistically expect to achieve a net savings of at least 20 percent in comparison to its domestic standard costs. So, for example, a company with a first year purchasing budget of \$10M could expect to save at least \$2M by purchasing those materials in Asia. The cost of establishing and operating a modest but capable IPO office in the Far East varies considerably from country to country but on the average will cost at least \$400K in annual operating expenses. A second office in another country would of course result in roughly twice that amount, etc. This is why a very large purchasing volume is necessary for any company considering to open its own IPO network in Asia today. In this example, a \$10M purchasing volume at 20 percent cost reduction would equate to \$8M in Asian purchasing value. Thus a single office would represent a cost burden of 5 percent against the net cost savings (\$400K/\$8M); a network of 2 offices a burden of 10%, etc.

Other than the obvious issue of increased expenses to maintain multiple Asian offices, establishing a single Asian buying office will have several disadvantages that need to be very carefully considered, in comparison to establishing a separate office in each individual country. Among the disadvantages of establishing a single Asian office:

- Limited knowledge of sourcing opportunities outside the IPO host country location
- Inter-Asia cultural & language barriers
- Nationalism constraints & governmental laws
- Controlling Asian suppliers located outside of the host country location  
(No daily presence, source inspection, technical & quality issues, etc)

Still, if your purchasing volumes will be large enough to justify the cost, establishing your own network of Asian buying offices offers the greatest degree of control and is eventually a low-risk approach.

## II. Purchase Asian goods 'at home' through sales agents or domestic offices of Asian suppliers

Purchasing Asian goods through local sales agents or domestic offices of Asian suppliers is never a good solution, as it invariably results in leaving money on the table and therefore minimal cost savings in comparison to buying the same goods directly from the Asian factories on an FOB Far East basis. Moreover, purchasing locally will put maximum demands on your domestic purchasing organization, will result in a low level of control over supplier quality and delivery, and typically will involve moderate-to-high risks. Along with the increased risks can be expected a corresponding increase in technical and quality issues, resulting in internal disruption and frustration and inevitably, high international travel expenses. In addition, by purchasing Asian goods only through domestic channels, your company will never have the opportunity to know what is transpiring in the Far East, who are the best suppliers, or what is really happening in the factories of the suppliers you have placed orders with.

### III. Purchasing in Asia on a direct basis from your domestic home office

In an effort to obtain lower prices for Asian goods than are obtainable through domestic channels, some Western companies have been tempted to purchase directly from the Asian suppliers. This usually involves extensive and frequent trips to the Far East by teams of Purchasing, Engineering and Quality personnel to visit and survey potential suppliers, who eventually will be turned over to the company's domestic purchasing staff to manage from great distances, heavily dependent on email, fax and voice communication channels with the Asian suppliers. If you are thinking that this sounds like an extremely risky, difficult and potentially frustrating approach to the problem, you couldn't possibly be more correct. I happen to have accumulated more than 30 years of experience doing business in the Far East and over the course of my career have become familiar with hundreds of companies who were either doing business in Asia or attempting to do so, and I can say that in all that time I have yet to find a single Western company doing business in Asia in this manner successfully over any significant period of time. I would not recommend this purchasing strategy to any company, under any circumstances.

It is my personal opinion, that the fundamental prerequisite for doing business successfully in any distant part of the world is to maintain a daily presence in those countries, capable of communicating with the suppliers in their native languages, so that you have the means to monitor production in the supplier's factories, resolve technical and quality issues expediently as they arise, perform inspection of the goods prior to shipment, and assure that in all cases, products are being made to purchasing, product and quality specifications. This simply cannot be accomplished by phone, fax and email and the results can be catastrophic. Trying to do business directly with Asian suppliers from your home office without the benefit of professional, local support is an extremely high-risk approach and should be avoided at all cost.

### IV. Enlist the services of a professional, independent IPO organization

This brings us to the fourth and final approach: enlisting the services of a professional, third party IPO organization. As mentioned, in order to obtain the lowest prices, you need to develop the ability to purchase directly from the Asian suppliers, in Asia, on an FOB Far East country-of-origin basis. And to do this in a manner that does not result in increased risk factors requires that you maintain a daily presence in each Asian country where you intend to purchase. One interesting option that represents a much lower cost alternative to establishing your own network of international purchasing offices is to enlist the services of an independent, international purchasing organization.

One such organization worthy of consideration is Bolnar International Ltd. Bolnar is a pioneer in the field of global procurement. Incorporated in Hong Kong in 1982, Bolnar has been assisting Western high-tech companies in purchasing high-quality, low-cost Asian products for the past 19 years, and actually created the concept of a *cost-shared IPO organization*. Under this concept, each participating client can enjoy the benefit of Bolnar's many years of experience, impressive portfolio of qualified suppliers and Asia-wide network of IPO offices at a small fraction of the cost they would incur by establishing their own network of Asian support offices. Bolnar currently maintains professional, fully staffed purchasing and technical support offices in Korea, Taiwan, Hong Kong, Shanghai, Singapore and India, as well as customer support offices in both the United States and Europe.

Procurement cost burden under this type of arrangement is extremely low, since operational expenses are shared among participating client companies. Risk is also extremely low... each Bolnar office is staffed with a veteran group of multi-lingual engineers, technicians and business specialists to oversee each project through the complete procurement process; from supplier selection and certification, development and submission of first-article samples and tooling, and throughout the entire manufacturing process. Bolnar's professional Asian staff are trained to make certain that the products ordered by its clients are developed and produced in strict compliance with the client's quality and performance requirements.

Bolnar's services range from engineering supervision of new tooling projects, supplier screening and certification, conductance of in-process quality audits and lot acceptance testing, negotiation of prices and purchasing contracts, resolution of technical and quality issues, ongoing supplier management and freight consolidations and traffic management.

For most Western companies, buying components or having products assembled in Asia can be a risky proposition... Language barriers and miscommunication, errors made in the interpretation of instructions and specifications, misunderstandings of infinite variety and cultural differences can all add to the difficulties of establishing and maintaining a successful offshore program. Yet, for companies able to overcome the obstacles and minimize the risks, the potential cost savings from Far East Sourcing can be very significant, and will help those companies compete effectively in today's difficult international markets.