Procurement Director *forum* 2011
E x e c u t i v e c i r c l e

Un nuovo Contesto Globale, un nuovo Mix Competitivo: il mondo sta cambiando…
Ha “ancora” senso parlare di “Global Sourcing”?
Cosa sta “davvero” succedendo sui mercati globali?

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Un nuovo Contesto Globale, un nuovo Mix Competitivo: il mondo sta cambiando…

L'ultimo biennio ha confermato il ruolo globale delle Economie Emergenti e la forza propulsiva delle Aree Asiatiche.

Questi mercati si presentano oggi con nuovi aspetti competitivi:

- *Oltre la Fornitura e la Produzione, mercati di Vendita con mix di comportamenti Globali e Locali*
- *Oltre il Costo del Lavoro, contesti sempre più maturi di Competenze e Tecnologie (… e possibile competizione)*

È un nuovo "Global Mix", Cina ed Emergenti stanno "riplasmando" la prospettiva del business internazionale:

- *Competenze e Tecnologia in rapida maturazione*
- *Livelli Qualitativi in evoluzione verso Standard Internazionali*
- *Costi crescenti ma ancora competitivi*

Sulla base delle nostre esperienze e degli stimoli più attuali che ci provengono dai mercati*, un percorso di discussione articolato in due momenti:*

- ***Workshop - Attrattività e Rischiosità del "Global Sourcing", un confronto tra Aziende italiane***
  - *Esperienze e Prospettive delle Aziende Italiane in questa fase del ciclo economico*
- ***Seminario - Attualità e Dinamiche del "Global Sourcing", un confronto in diretta "Italia-Cina***"
  - *In collegamento con Shanghai, Professionisti Italiani e Cinesi presenti sul "campo": esperienze e "feeling" di chi vede le cose "dall'altra parte del mondo"*

Ringraziamo tutti i partecipanti per il livello della discussione e la volontà di confrontarsi apertamente su queste tematiche

William George Group, a Network of Practitioners with a solid background in international business management and consulting

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William George GROUP

As international management consultants, we support our clients in planning and implementing business opportunities in the world fastest developing markets.

We assist our clients along the entire Business Cycle, with a complete set of Services:

- *Business Advisory and Strategy*
- *Business Planning and Execution*
- *Global Operations and Supply Chain*
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Our Offices are in Boston, New York, Shanghai, Hong Kong, New Delhi, Milan and Rome

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Over the last 10 Years, the dynamics of the Global Economy have been changing …

A two-speed world is emerging:
- Slower Growth in the developed economies (U.S., Europe, Japan)
- More Rapid growth in Southeast Asia and BRIC countries

The global context is increasingly uncertain and unpredictable.
Due to some key factors:
- Global and Local Demand Fluctuation
- Commodity and Currency Volatility
- Regulation and Trade Barriers changes (or even trade wars)

Companies with Global Supply Chains must be adaptive and flexible:
- Re-designing their entire Distribution, Production and Sourcing Footprint
- Re-considering their Operating Models, to sustain an uncertain future ("feel the wind of change")

Procurement Models will be stressed by different Demand Patterns (High-growth, Low-growth Markets):
- Local for Local
- Local for Global
- Global for Global ("Best of Breed" / "Cherry Picking")

… and Companies are rethinking their Global Sourcing strategies

Growing costs may reduce labor savings, decreasing overall the cost advantage.
Some new challenges are emerging:

- Growing Labor, Logistics and Input Costs
- Quality Concerns
- Risks of managing Long Supply Chains

Recent decisions seem to suggest a migration back to "Near Shore" countries:

- Eastern Europe or South Mediterranean for the European Union
- Mexico for the United States

But Global Sourcing is here to stay, the focus moving from Labor Cost to Total Cost (referred to Target Markets)

No longer restricted to labor-intensive products, Companies are sourcing globally a wider range of products:

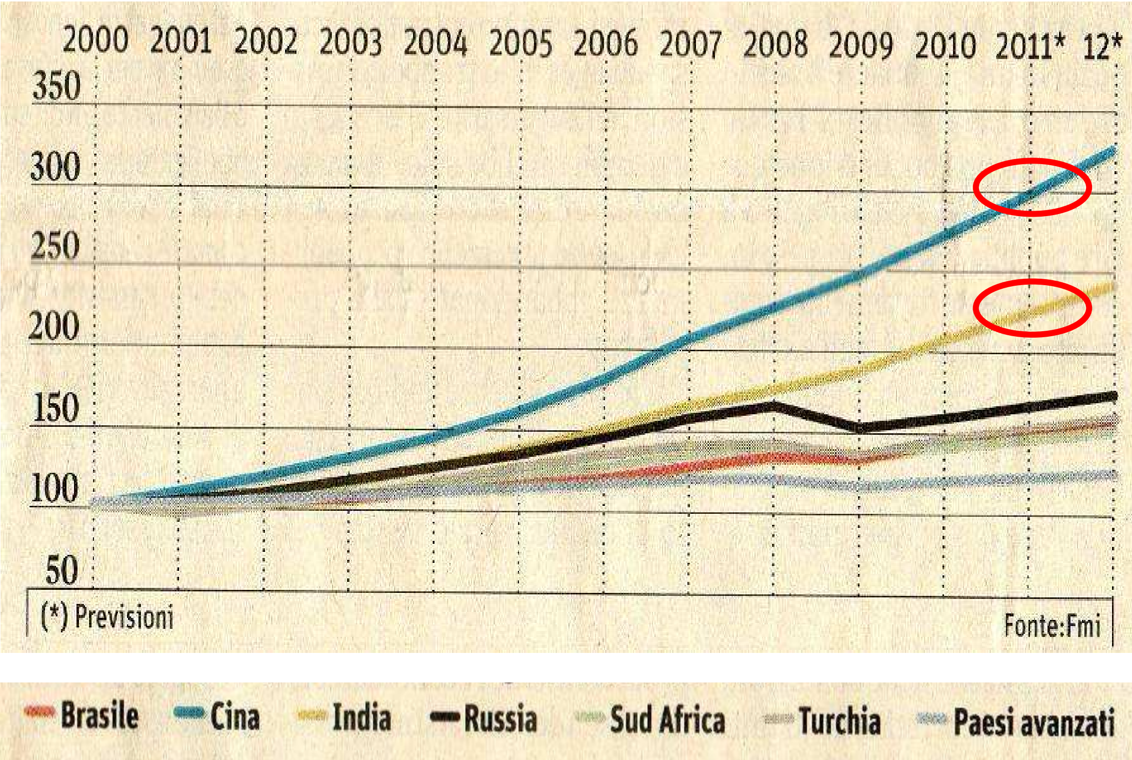
- to capitalize on the combination of Low Costs and Higher Technology/Skills
- to access consumers in emerging markets

The unidirectional model ("Source East, Sell West") is being replaced by a networked model of Supply Hubs.

Companies will rely on a diversified base of suppliers across multiple regions.

A two-speed world is emerging

Crescita delle principali Economie (PIL Reale, Base 2000=100)



Paesi Emergenti non dipendono più nei destini dalla domanda interna delle nazioni ricche, ma sono loro che danno impulso alle produzioni di queste ultime…

La frenata globale sarà superata grazie al continuo sviluppo dei nuovi mercati, in particolare asiatici.

La crisi ha dimostrato il cambiamento epocale:

- la crescita mondiale ha una solida colonna portante nello sviluppo dei Paesi Emergenti, soprattutto Asiatici
- La Cina da sola fornisce un terzo della crescita globale

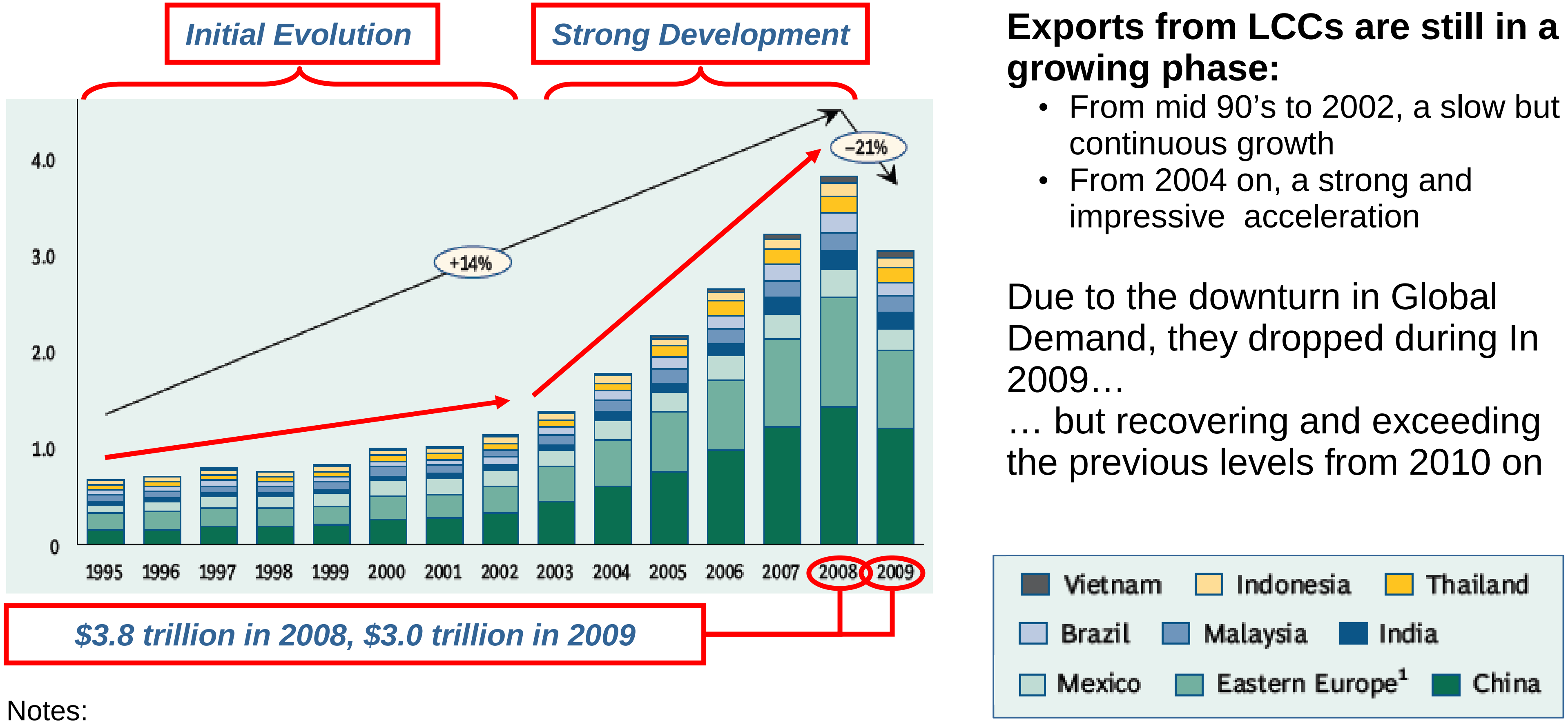
Nell’ultimo decennio:

- L’India ha più che raddoppiato il proprio PIL
- la Cina l’ha addirittura triplicato

Source: FMI; Sole 24Ore, 2 Agosto / 17 Giugno 2011

Exports from LCCs are still in a growing phase …

Exports from Low Cost Countries (U.S. $ Trillions)



Exports from LCCs are still in a growing phase:

- From mid 90's to 2002, a slow but continuous growth
- From 2004 on, a strong and impressive acceleration

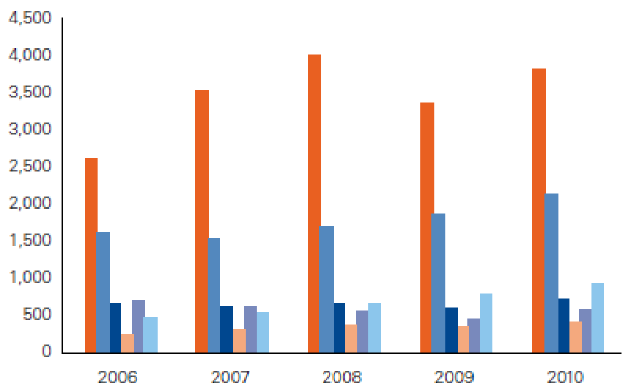
Due to the downturn in Global Demand, they dropped during In 2009…
… but recovering and exceeding the previous levels from 2010 on

Notes:
- 2009 Data: Bulgaria, India, and Moldova are estimates
- 1: include Belarus, Bulgaria, Czech Republic, Hungary, Moldova, Poland, Romania, Russia, Slovakia, and Ukraine.

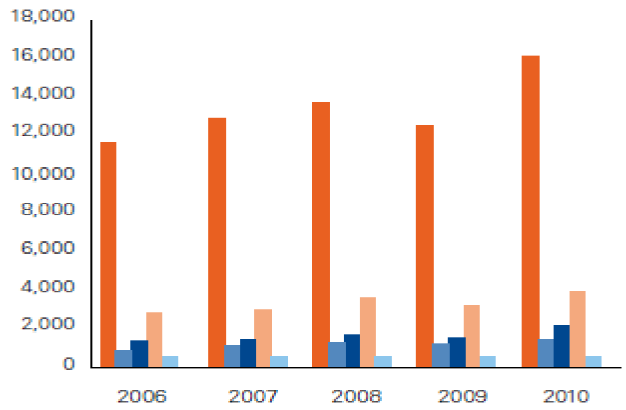
Source: Economist Intelligence Unit; BCG; WG analysis

… and China remains the principal source for many manufactured hard goods

Cotton Shirts and Blouses (MUS$)

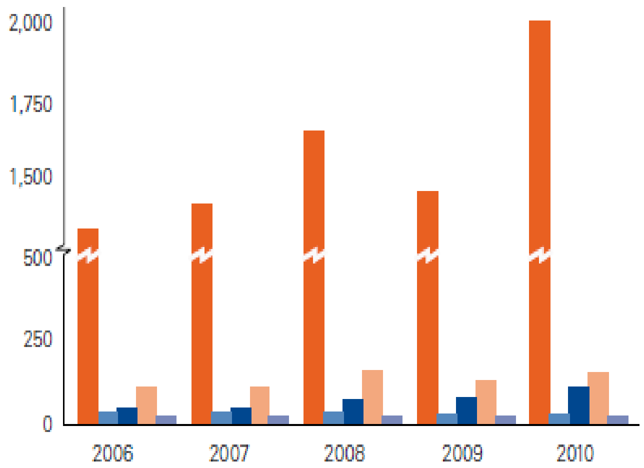


Footwear: Leather or Upper Textiles (M US$)

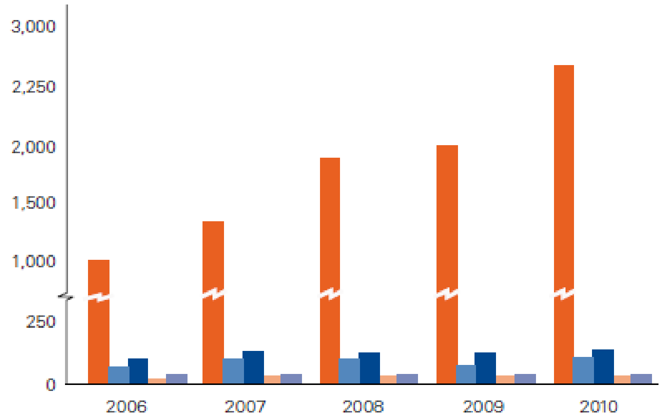


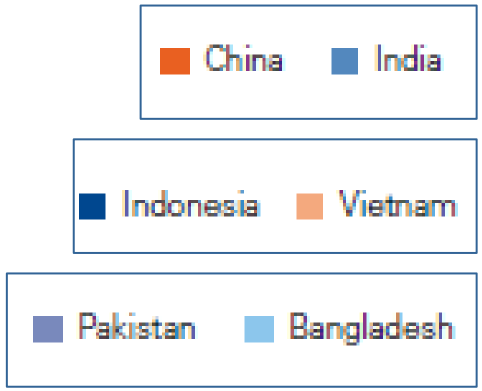
Due to scale and high productivity levels, China is expected to remain the largest sourcing market

Leather Goods: Bags, Accessories, Leather Apparel (MUS$)



Glass Home Ware Products (M US$)





Sources: UN Comtrade statistics; KPMG

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Attrattività e Rischiosità del "Global Sourcing", un confronto tra Aziende italiane

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Queste aree si presentano oggi con nuovi aspetti competitivi che richiedono un serio approfondimento:

- *Oltre la fornitura e la produzione, mercati di vendita con mix di comportamenti Globali e Locali*
- *Oltre il Costo del Lavoro, contesti sempre più maturi di Competenze (e possibile competizione)*

È un nuovo "Global Mix"*, Cina ed Emergenti stanno "riplasmando" la prospettiva del business internazionale:*

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- *Standard Qualitativi in evoluzione verso livelli internazionali*
- *Costi crescenti ma competitivi in rapporto al livello qualitativo*

Alcuni elementi devono essere chiaramente compresi e costantemente monitorati:

Attrattività e Rischiosità dei mercati emergenti

- *Fattori di Costo e loro Evoluzione: Lavoro, Energia, Logistica, Fiscalità …*
- *Maturità di Competenze e Tecnologie: Qualità dei Prodotti e dei Servizi*
- *Maturità relazionale e gestionale: Affidabilità dei Fornitori*

Come muoversi

- *Selezione dei mercati: Quali prodotti, Quali servizi, Quali alternative (mercati vicini/lontani)*
- *Meccanismi operativi: Quali Canali, Quali Strumenti*
- *Passi operativi*

Un'occasione per confrontarsi sulle Esperienze e sulle Prospettive delle Aziende Italiane in questa nuova fase del ciclo economico

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Growing costs may reduce labor savings, decreasing overall the cost advantage

Labor dynamics

- Labor shortages have led to higher wages
- Even if improving, Automation and Productivity have accelerated much slower than Labor Costs
- Labor Organizations are demanding higher wages and benefits
- New Labor Laws give greater rights to workers

Input Costs

- Production and Logistic costs are changing: Energy, Transportation, Industrial Land
- Commodity Price Fluctuation has dramatically increased
- Currency Volatility make Potential Savings increasingly unpredictable

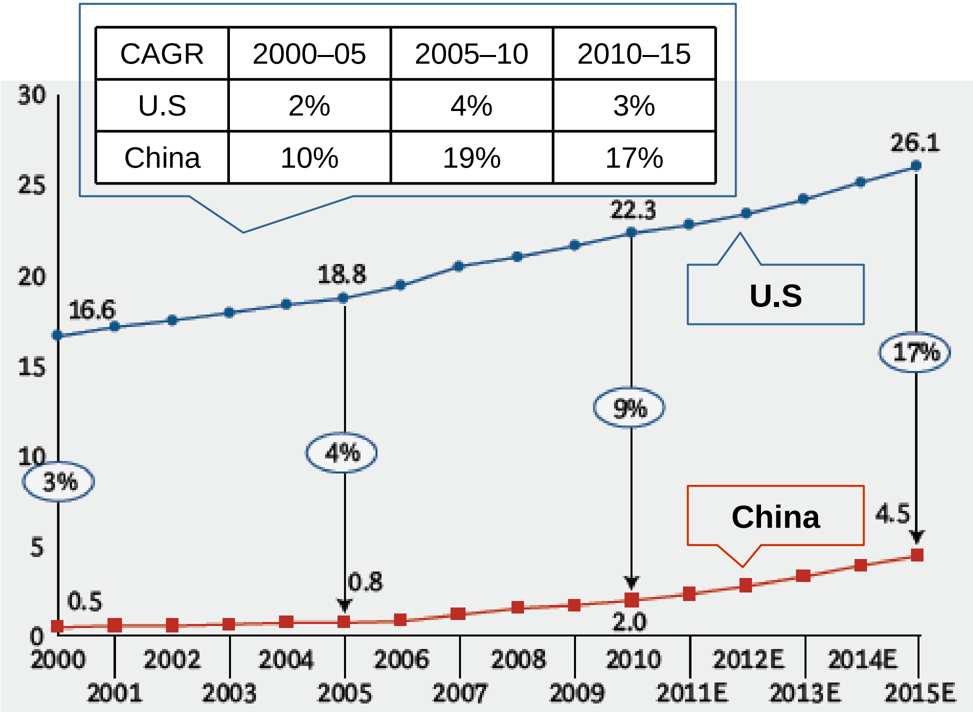
Other Cost Pressures

- Taxes, Customs and Regulations are continuously changing
- Environmental, Health and Safety Costs are increasing
- Impacts of Long Supply Chains are heavy (inventory, shipping and reaction times)

Rising Labor Rates have been a fact of life in Chinese factories for years

<u>Fully Loaded Factory-worker Wages (China, U.S.; $/hour)</u>

CAGR	2000–05	2005–10	2010–15
U.S	2%	4%	3%
China	10%	19%	17%



Ratio of average Chinese to average U.S. wage rates

The last few years have been especially volatile in China.

Pay and Benefits have been rising constantly from 1999 on:

- 10% in 2000-05
- 19% in 2005-10

Minimum wages rose by:

- +20% in 20 Chinese regions

Opportunities in other Low Cost Countries are really interesting:

- $1.80 in Thailand*
- 49 cents in Vietnam*
- 38 cents in Indonesia*
- 35 cents in Cambodia*

*: Fully Loaded Factory-worker Wage - Average

Sources: “Made in America, Again”; BCG

Input Costs are changing the cost equation and Currency Volatility make Potential Savings increasingly unpredictable

The cost of electricity has surged by 15% since 2010.

Ocean Shipping rates remain low, but expected to boost by 2015:
- Rising Oil Prices
- Reduction in new Shipbuilding
- Shortage in container Port Capacity

Industrial Land is no longer cheap and still controlled and owned by Government:
- $21 in Shenzhen*
- $17.29 in Shanghai*
- $11 in Nanjing

*: Selected Industries only (Hi-tech, Bio-tech, Green Tech, Logistic Services, Financial Services, …)

Renminbi appreciation is further increasing the price of Chinese exports:
- +13% from 2007 (vs $)
- expected to continue (but RMB not fully convertible on open-markets, in the near term)

Currency devaluation makes some country especially attractive:
- Relatively high-cost regions newly viable best-cost supply bases (South Korea, …)
- historically low-cost countries even more attractive (Mexico, Vietnam,…)

No longer restricted to labor-intensive products, Multinationals are sourcing a wider range of products

Skills and Suppliers

- The Skill Level is rising due to demand for greater quality, better processes and higher level of automation
- Suppliers are proving to be credible substitutes for Western suppliers
- Product Quality is today at world-standards in China and in South-East Countries (but Potential Problems still present)

Technologies and Products

- Categories of goods are expanding from Labor-intensive Products to Technology and Capital-intensive Products
- New Geographies are emerging

Market transparency

- A Greater market transparency helps companies to set up direct sourcing arrangements
- Intellectual-property and Trade Disputes are still concerns
- Political risks, corruption and personal safety are added concerns in some countries

Suppliers are proving to be credible substitutes for Western suppliers…

Companies are finding a growing number of suppliers with Product Development and Extensive Manufacturing experience.

A direct correlation exists between Quality Levels and Degree of Industry Regulation (Pharma, Automotive, …)

For virtually every product, the market is actually made of two distinct markets:
- “Local for Global” (higher tech, higher price)
- ‘“Local for Local”’(lower tech, lower price)

On Intellectual Property Rights:
- Situation drastically improved (last 2 years)
- only “waves of innovations” can preserve products/components from being copied

Intercultural issues and openness to international markets are still critical challenges

Suppliers Maturity to be evaluated on:

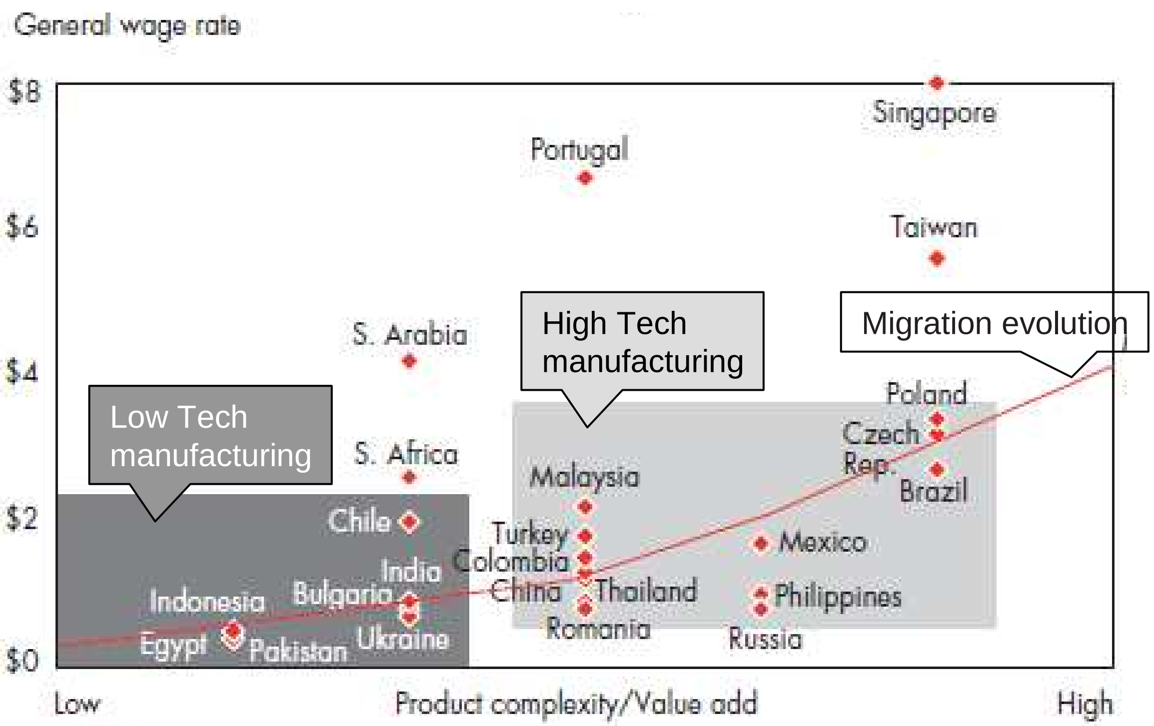
BtoB Relation / Process Satisfaction:
- Select suppliers who already have a consistent international business.
- No more time to develop local suppliers to international standards (sometimes the development is potentially regressive - intercultural issue!)

Product Quality
- Under the pressure of Quality Management by multinationals, Product Quality is today at world-standards in China and in South-East Countries (Vietnam, Thailand, …)
- “Good Enough” or “Chinese Quality” are no longer acceptable.

Local On-going control is the key to guarantee consistency in Product Quality and Order/Process satisfaction.

… and Export Categories have been expanding from Labor-intensive to Technology/Capital-intensive Products

Opportunities to migrate Manufacturing Costs



In the new context, Labour Costs and Value Added are driving the construction of Potential Portfolios…
Including:

High-Tech/High Complexity Goods:

- Automobiles
- Airplanes
- Complex Mechanical
- Electronics
- Automation equipment.

Low-Tech/Low Complexity Goods:

- Textiles
- Basic Consumer Goods
- Simple Mechanical Devices (switches, circuit breakers)

Source: “Making the move to Low Cost Countries”, Bain & Co.

Over the past decade, in China we have been seeing a clear shift to Technical/Engineering Components and today we have a completely new landscape

Reflecting China's emergence as a higher-quality provider, we see a migration:

- **from Traditional Segments:** Transportation, Textiles, Consumer and Retail
- **to High-growth/Highly attractive markets:** Electronics & High-tech, Industrial Equipment, Automotive, Chemicals, Pharmaceutical & Medical, Media & Entertainment

Machinery and Electrical Equipment have been recording the highest growth in exports

China has evolved from supplying Simple Components to Complex Systems

Today, China is a Global Leader in many of its Top Export Categories:

- Electrical Machinery and Equipment
- Power generation equipment
- Apparel and Clothing Accessories
- Furniture, Lighting, Signs, Prefabricated Buildings

- *Technology-based suppliers, mostly on the Coast*
- *Electronic & High-tech Suppliers, controlled /derived by Taiwanese and Japanese Companies*

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Companies are working to redesign their Operations Footprint, leveraging new opportunities and reducing risk exposure

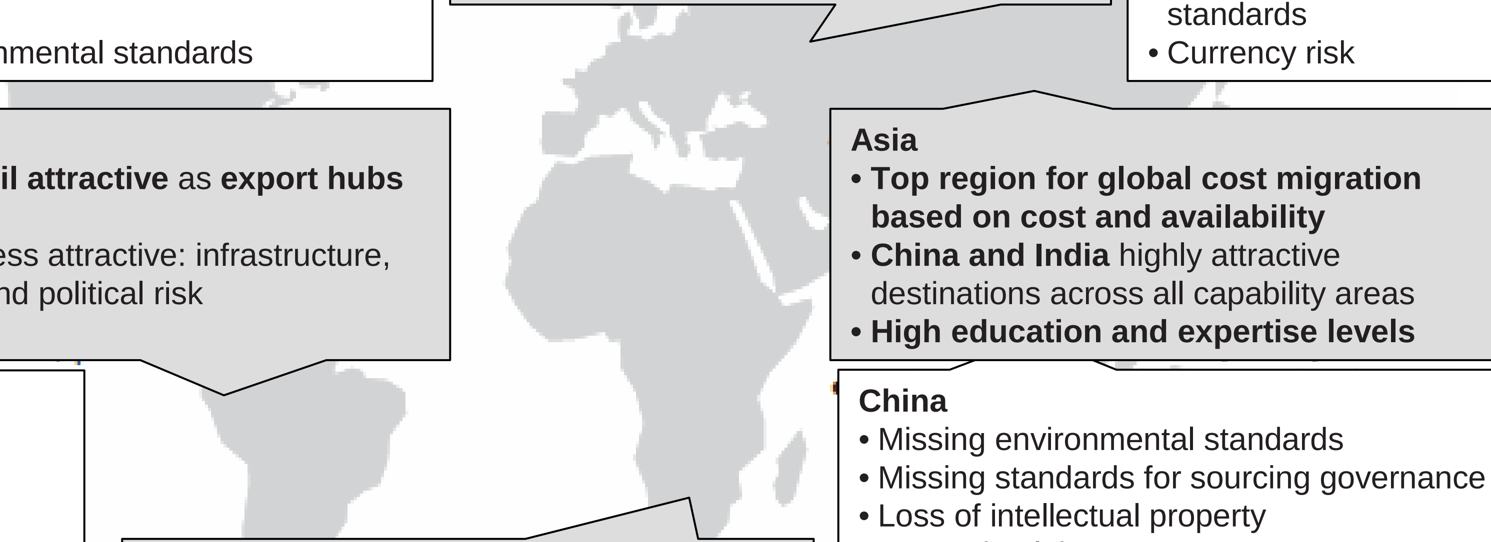
Portfolio Approach

- Risks and uncertainty of labor shortages, currency volatility, and protectionism drive needs to a more balanced portfolio
- The Unidirectional Model ("Source East, Sell West") is being replaced by a Networked Model of Supply Hubs
- Global Supply Chains need to balance Local Costs, Competence Availability, Socio-economic Risks and Proximity
- Companies need to invest in developing alternative suppliers before any diversification of volume can be initiated.

Global Make or Buy

- With improved capabilities and educated labor available, complex activities can be targeted for migration
- Companies are transferring other steps of the value chain beyond sourcing (R&D, Assembly, Manufacturing, …)
- Companies are also leveraging their Sourcing Bases in emerging regions to support penetration in Local Markets (Localized Products, Re-designed/Low Price Products, …)

Global Supply Chains need to balance Local Costs, Competence Availability, Market Proximity and Socio-economic Risks



Eastern Europe
- Increasing labor cost
- Fraud/compliance
- No innovation from suppliers
- Bad/missing local supplier performance management
- Missing environmental standards

Eastern Europe
- **Most convenient for EU companies**
- High education and expertise levels
- EU expansion could erode long-term cost advantage

Russia
- Political risks
- Fraud/compliance
- Trade regulations/customs
- Missing environmental standards
- Currency risk

Latin America
- **Mexico and Brazil attractive** as **export hubs for NA markets**
- Other Countries less attractive: infrastructure, poor education, and political risk

Asia
- **Top region for global cost migration based on cost and availability**
- **China and India** highly attractive destinations across all capability areas
- **High education and expertise levels**

Brazil
- Currency risk
- Trade regulations /customs
- Missing environmental standards
- No innovation from suppliers

Middle East and Africa
- Minimal cost migration activity
- **Below average education/expertise levels**
- Lack of major markets

China
- Missing environmental standards
- Missing standards for sourcing governance
- Loss of intellectual property
- Increasing labor cost
- Appreciation of RMB
- Fraud/compliance

India
- Missing Stds for sourcing
- Missing environmental Stds
- Poor infrastructure
- Increasing labor costs
- Quality problems

(grey box): Local Costs, Competence Availability (white box): Socio-economic Risks

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Attualità e Dinamiche del "Global Sourcing", un confronto in diretta "Italia-Cina"

I mercati "Emergenti" hanno percorso una traiettoria di forte evoluzione lungo gli ultimi venti anni *e si presentano oggi con caratteristiche profondamente cambiate rispetto a quelle storicamente conosciute.*

Nel prossimo futuro ulteriori cambiamenti si possono già prevedere e in parte sono già pianificati.

Attualità e Dinamiche evolutive di queste aree devono essere approfondite per tarare nel modo più opportuno le scelte di business delle aziende occidentali.

Il mercato Cinese rappresenta un punto di vista privilegiato per comprendere "dove va il mondo".

L'attualità e le ulteriori trasformazioni attese in questa area influenzeranno e scelte delle Aziende Globali e l'evoluzione industriale delle Aree Geografiche "alternative".

Alcuni temi vanno quindi affrontati e compresi in modo concreto e diretto:

- *Evoluzione del Rapporto Qualità/Prezzo, Prodotti e Servizi competitivi*
- *Maturità dei Fornitori, Interessi e Comportamenti attesi*
- *Scelte industriali e Aree Geografiche alternative*

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A combination of economic forces is eroding China's cost advantage as a Global Export Platform …

Wages are increasing in the range 15 to 20% per year (inflation at 9% officially, but double for food)

New labor law gives greater rights to workers (valid July 1, 2011) **:**
- more difficult to fire workers
- severance packages
- increased contributions for non-resident workers/migrants and for foreigners

Labor Organizations are demanding higher wages and benefits

Strong concerns are stil present:
- Intellectual Property Rights (IPR)
- Trade disputes

In the coming 5 years, Manufacturing in China will loose cost advantages, when all costs are fully accounted for. Including Labor, Inputs and:
- Transportation & Warehousing
- Industrial real estate
- Taxes, Customs and Duties

… but other Low-Cost Countries will not be able to absorb Export Volumes that could be leaving China

There is no replacement for China's Labor Force:

- the world's largest population (1.3 Billion)
- the highest share of adults (>80 %)
- More than 200 M industrial jobs (60% more than SE Asia and India combined)
- Around 20 million people every year moving from countryside to cities

Chinese workers are more productive than workers in other Low-Cost Countries

Automation and productivity improvement actions are not fully implemented

China offers a Total Package unmatched by any other Low Cost Country:

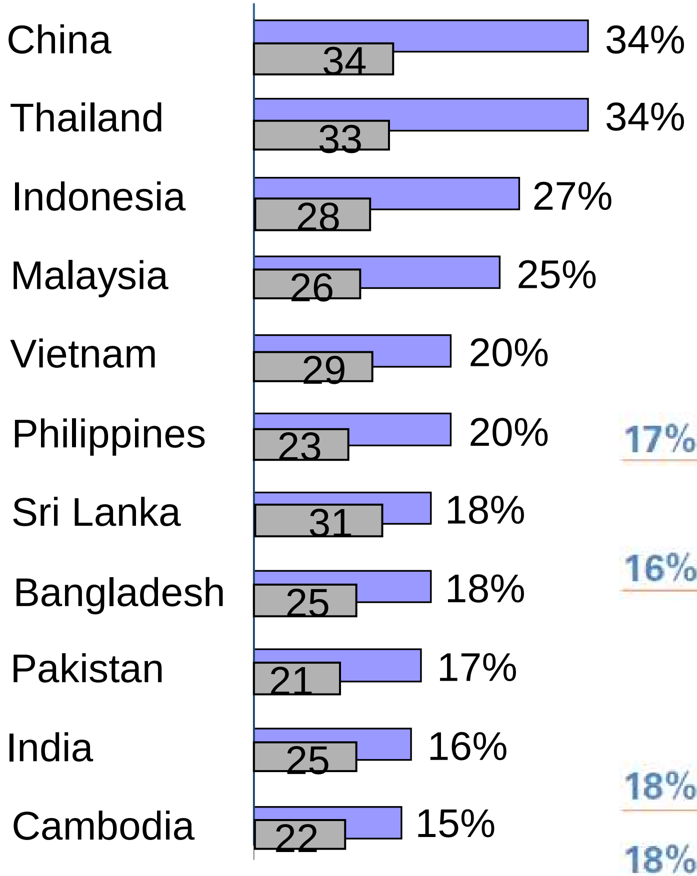
- Skilled Talents
- Low-to-High Technology offering
- Developed Supply Networks
- Developed Infrastructure
- Clear Government Policies

Central and Local Government pressure to develop the economy has created a competition to provide the best incentives* (on which burocrats are evaluated)

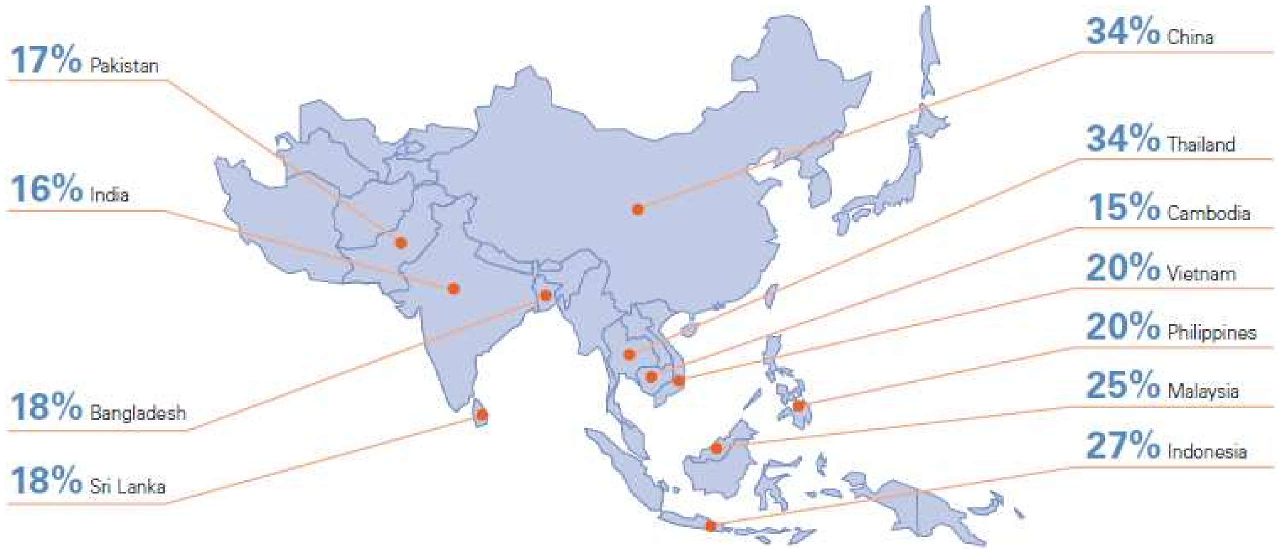
*: selected industries, selected areas

China has a rapidly aging population and New Countries are very similar to China in the early 1990s (average age 10 years lower)

Manufacturing Shareand Average Age (% GDP; Years)



In some Lab-intensive Productions, there has already been a significant transfer to South and SouthEast Asia
(Apparel, Footwear, Sporting Goods)



Sources: World Bank; WG Analysis

China will remain the Manufacturing Platform for Asia and Europe

China will remain a global power in some Manufacturing Sectors, due to:

- Huge Domestic Market
- Installed base in Capital Intensive Industries
- Increasing pool of Labor force and Skilled Talent

Sourcing and Manufacturing will make sense for Products combining Labor and Technology.
Other productions will be moved to "second tier" Countries in Asia.

These productions must be aligned to the interest of the Central Government
(detailed in the last 5-Year Plan)

Companies will orient their production to serve China and the rest of the growing Asia

China will continue to be a major low-cost export base for Western Europe
Even if the wage gap will narrow significantly

US Companies will be re-thinking their Manufacturing Platforms.
Due to US Government incentives, NAFTA agreement and disputes on trade-barriers.

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Experiences and "Feeling from the field"…

Global Make or Buy
(High Tech Group)
Re-design of the Sourcing Strategy, considering new potential Markets/ Suppliers in Asia:

- Cost Model definition and Current Costs Analysis (TCO as-is).
- Supply Market analysis (China, India, North Africa)
- Country risk analysis
- Country selection and Total Cost of Ownership (TCO).
- RFQ for a selected group of SKU's in selected Countries.

Global Make or Buy
New business start-ups (6 new businesses) in China for exporting to European market:

- Feasibility Studies
- Suppliers Scouting, Selection, Qualification
- Analyses of suppliers capabilities to provide end-to-end products
- Set-up contracts, prototypes-production and on-going quality control
- Monitoring of all Supply Chain Steps (physical and administrative)
- Long-term plan for Continuous Improvement in Purchasing Total Costs, shared with suppliers.

Business Planning & Execution
(Technology leader in Air Conditioning)

- Developed Business Plan to enter China
- Set up JV in China
- Identified, selected, and developed supply network to JV in China
- Established operating procedures, cash-control, financial reporting related to suppliers and customers
- Continuous monitoring of the supply-base and continuous improvement of quality and deliver targets.

… what we have recently done

For Chemical Industry: Scouting and Purchasing for plastic raw materials (e.g.: PVC, CPE, PMMA, etc.)

For Pharma Industry: Market Analysis and trends for micronization, Sourcing for "active principles" produced in China

For Environmental Industry: Sourcing and Purchasing of Solar Panels and related components in China

For Motorcycle Industry (leading Motorcycle Company):
Sourcing and Purchasing for aluminum components/ parts, electric devices, mechanical parts, brakes, etc

For Textile Industry: Sourcing and Purchasing for interior furnishing

For Mechanical Companies:
Sourcing for different types of semi-finished products (copper, steel, plastics/moulds,…) for Companies in Italy, Germany, Switzerland working in the machinery industry (industrial machines for industrial production processes).

- Il mondo sta cambiando: Tra crisi e ripresa, nuovo ruolo degli “Emergenti”
- Workshop - Ha “ancora” senso parlare di “Global Sourcing”?
    - Attrattività e Rischiosità dei mercati emergenti
    - Un Approccio rinnovato
- Seminario - Cosa sta “davvero” succedendo sui mercati globali?
    - Il Fenomeno Cina: Presente e Futuro
    - Esperienze e “feeling “ dal campo: Alcune Case Histories
- Come Muoversi …
- About William George Group

Doing business in Asia is an evolving proposition and a Long-term run, ultimately becoming a regular way of doing business

A Phased approach need to be applied, based on four key Steps:

- Assess
- Select and Develop
- Control
- Evolve

Companies need to invest in developing alternative suppliers before any diversification of volume can be initiated

An "Hub & Spoke" approach is required where the Regional Market is pivotal

- Suppliers must be selected within Regions and developed to Global Standards

Be "Present Locally" but "Open Globally", monitoring Suppliers and Competitors

- Bring Purchasing Know-how and Purchasing Requirements to Asia/China (and impose them to pre-select suppliers)
- Support Local Units in reaching International Standards in all competitive dimension and track their consistency over time.
- Create Global Benchmarking Scorecards (making possible to pick and choose the best)

Assess, Select and Develop, Control, Evolve

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As international management consultants, we support our clients in planning and implementing business opportunities in the world fastest developing markets: China, India and South-East Asia.
Bridging Europe and Asia with our mix of global perspective, local presence and deep expertise.

Our mission is:
"To help clients taking advantage of the extended business opportunities in Asia".
Together with our clients, we build Solid and Sustainable Business Initiatives based on:

- a bridge between cultures: building relations, before making business in Asia
- a credible business environment: seniority of our professionals and local partners
- personal and business trust: long-term support and achieved results with clients

The factors of our unique business proposition are:

- Asian focus and perspective: physical presence in China since 2004, in India and in Singapore
- Result-oriented partnership with clients
- Proven competencies and business seniority
- Reliable network of business relationships and partners
- Global and integrated network: US, Europe, Asia

What we do. We assist our clients along the entire Business Cycle, with a complete set of Services

- Business Advisory: Market Analysis and Business Evaluation; including Funding and Partner Screening (JVs and M&A)
- Business Planning and Execution: Enterprise Set-up and Operational Ramp-up; including Legal and Executive Search
- Global Operations and Supply Chain Design: Global Make or Buy Analysis, Global Sourcing, Operations and Logistic Set-up
- Business Running and Reporting: Operations Support and Financial Monitoring; including Accounting, Auditing, Fiscal and HR Assistance

What we have done and what we have achieved.
Over the last 5 years, we have worked in a wide range of industries: Industrial Manufacturing and Automation, High Tech, Consumer Goods and Logistics.
Our collaborative and result oriented approach resulted in long lasting relationships and contracts.

Who and Where we are. A professional network of practitioners with high seniority and solid background in international business management and consulting. Our Offices are in Boston, New York, Shanghai, Hong Kong, New Delhi, Milan and Rome