

Purchasing in China

Key factors 2013 and beyond

This white paper describes Mr. Rudy Kuo's view of purchasing in China in the year 2013 and beyond. It provides an overview of the factors to be taken into account before making the strategic decision to start a procurement program in China, and in the end a new and different approach is suggested for procurement in China.

Purchasing in China *can* lead to lower product costs, and *can* lead to savings. But does it *always* result in lower costs? The answer is unfortunately 'no'.

So the key question is: what products are interesting to purchase in China, and for what reasons?

Since my arrival in China in 2002 China's purchase market has changed significantly. At that time basically anything produced in China resulted in cost savings. But nowadays, in the year 2013 many of those products are not profitable enough any longer to procure in China. Some of them are even more suitable for production in other (Asian) countries. Examples of those products are products, which require few production steps and are produced mainly by machines such as: hdpe bags, hdpe bottles, polyester pulling wire, PE/HDPE/rubber disposables, galvanized metal tube (line welding), etc.

7 Challenges

There are different reasons for certain products to have lost their savings potential in China over the last decade. Some are commonly known, while others are more industry specific, seven have been listed below.

1. Increased costs
 - Labor
 - Land, rental
 - License (environmental)
 - Cost of capital & RMB appreciation
2. Quantity too low (mostly < 20 ft. container);
 - High upfront investment costs, e.g. mold cost per product unit;
 - High transport and customs cost per product unit;
 - Higher material costs per product unit as manufacturers buy raw materials at MOQ's.
3. Quantity too high.
 - Normally this would be a prerequisite to purchase in China, but if quantities are too high, then for simple products that can be produced mostly/completely by machines, the cost per unit could be lower in Western countries than in China, partially also due to more efficient machines in the West.
4. Reduced export rebates / changing government policy
 - The government used to stimulate exporters by providing export rebates on VAT. These have significantly been reduced, sometimes to 0%.
 - More export quotas have been established over the last years.
5. Inconsistent raw material prices.
 - Certain raw materials are controlled by large conglomerates in China, which can have an upward effect on prices.
6. Production methods.
 - Specific production methods in China are more expensive than in Western countries.
 - i. For example: punching/stamping holes in galvanized plates that are to be formed into tubes, is more expensive in China.
7. Low profit margin factories
 - Most factories' profit margins are low. So any (sudden) increase in costs is hard to bear, forcing them to shut down or change industry. Hence leading to a decrease of low cost suppliers/products.

Purchase criteria

What circumstances do justify purchasing products in China then? Mostly it is a combination of the factors below.

1. Sufficient added value during the production process in China.
 - Customized high-tech products such as: High end metal components (truck or car components)
 - Machinery.
2. Abundant raw material available in China / scarcity of supply in client's country.
 - Sand/silicon for solar cells.
 - Aluminum ore (for production of processed minerals).
3. Government stimulated/subsidized industries.
 - LED
4. Purchase a group of products at one supplier to achieve efficiencies in quantity, logistics, and raw materials.
5. In some industries a shift can be seen in management from an older generation to a younger generation, which understands (long-term) Western business needs better, resulting in an enhanced purchase environment.

Conclusion

Deciding to setup a purchase program in China remains an important strategic decision. There are still many factors to consider before deciding to procure in China, of which some have been listed above, and of which some have changed over the years in form and importance. Hence, gathering and analyzing all necessary information in advance will be vital before entering China, in other words: be prepared.

In addition, looking back at the last 7-8 years, it is evident the purchasing environment has changed significantly. It is therefore imperative for procurement managers to also decide how to deal with the new situation. My suggestion would be to make a shift from a customer-supplier approach to more of a partnership approach, where more goals are aligned, and both parties share more information to build trust, and to develop markets, products, optimize costs, supply chain, etc. *together*. Finding an appropriate partner can take time, and largely depends on the owners/management of the factory, but it is one of the few ways to reduce risk and concurrently foster growth in your company.