

## Low-cost country sourcing supplement, 27 November 2008

### Strength in clusters

Roger Moser and Konrad Banziger argue that firms need to focus on specific sourcing 'clusters' in low-cost economies

Many sourcing managers face a new problem. Intensified global competition and the initial success of many (but not all) international sourcing initiatives has created demand from the board to increase sourcing from low-cost countries such as China, India or Vietnam. For example, most companies participating in a recent Supply Management Institute (SMI) study in India plan to at least double volume sourced from the country in the next two to three years.

When searching for products or services, sourcing managers are going for more complex, strategic categories. Most classic low-value, labour-intensive elements have been sourced worldwide for many years. The problem is that most sourcing managers try to take global sourcing to a new level with old recipes.

The traditional approach of following the lowest cost opportunities wherever they are leads to severe problems. It requires the transition of sourcing volumes from one region to another at short notice, along with low investments into local sourcing structures. The latest breed of sourcing initiatives - focused on complex, strategic products and services - do not lend themselves to this method. They require a long-term approach to the sourcing region, including the build-up of professional sourcing structures with highly qualified personnel.

The results of the SMI study suggest this mismatch and tension between long-term and short-term perspectives, as well as the missing high-quality support locally, are the reasons for some of the recently discussed problems in a number of global sourcing projects. As a result, some companies have realised they need to develop their newly focused global sourcing activities in the same way as they have entered new customer markets: cautiously and step by step. We argue that sourcing from 'clusters' offers this approach.

Clusters are, in general terms, geographically close groups of interconnected companies and associated institutions in a specific region. They consist of a collection of related networks that contain different levels of independent companies serving and ordering from one another. "Sourcing clusters" focus on the specific supply perspective of a company, such as raw materials, components, products or services.

This approach follows the economic insight that companies in such clusters are generally more competitive in terms of cost, quality and delivery, as a result of increased competition on the one

hand, and improved access to specialist labour (highly skilled or low cost), specific raw materials and other factors such as entrepreneurial spirit on the other. For complex, strategic products or services, a long-term focus on a specific region is required to build up the necessary expertise at headquarters as well as locally.

Clusters are a much safer bet on the future competitiveness of a specific sourcing region than any single supplier or other regional unit for long-term investment. In addition, the build-up of a strong sourcing office even enables companies to capture most of the benefits that a cluster offers to embedded companies.

### **CLUSTERS IN INDIA**

SMI India and BrainNet Supply Management Group have conducted a study into the strengths and weaknesses of the eight most important economic clusters in India for seven different products and services. This involved interviewing more than 150 Indian sourcing managers. The results are shown in the box on the left. They show the basic strengths and weaknesses of each economic cluster in general and the major selection criteria for sourcing clusters by Indian sourcing professionals.

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