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Risks and Countermeasures of Chinese Corporations Participation in Global Sourcing as Suppliers

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Abstract: On the ground of entering into the WTO, more and more Chinese corporations participate in global sourcing. Summarize the condition of Chinese corporations' participation as suppliers in global sourcing and analyze the potential risks, such as risk of holding inventory, receivable accounts, capital locked up, incomplete contracts and other risks such as non-tariff barriers and so on. And on the base, discuss countermeasures to them, such as giving the extended concept of cost and the procurement-supply sharing information system, forecast and contract protective terms, setting contract terms flexibly, scientific consideration of capital investment and so on.

Key words: Global sourcing, sourcing risks, countermeasure

INTRODUCTION

From 90s' in twenty century till now, with the further development of economics globalization and market globalization, both large scale transnational corporations and group of buyers point their new strategy at obtaining global resources at low cost. As a result, Global sourcing has become another profit increasing point chased by numerous transnational corporations. China, as a country with sustained and rapid economic development, becomes a world-renowned "manufacturing center" because of its comparative advantage formed by its superior labor factor endowment, the stable political environment and the continuously improved business environment.

In recent years, more and more global buyers has paid attention to China on 2010 China (Shanghai) International Sourcing Conference, the total purchase amount was about 26 billion dollars, up by 45% on an annual basis (Shanghai Business Newspaper 2010). Global buyers' spreading to China is accelerated and they are actively involved in moving their global sourcing center to China or establishing sourcing offices in China. The global sourcing center of Wal-Mart was moved from Hong Kong to Shenzhen; Carrefour established global sourcing center in Shanghai and regional sourcing centers continue to be set up in China, for instance. And such sourcing centers and offices established by these famous global buyers play a role of promoting Chinese corporations in participating in global sourcing as suppliers.

But at the same time, other data shows that the some serious problems exist: the global sourcing amount of the transnational retail groups in the world's top 500 enterprises was up to 2 trillion dollars, whereas the amount supplied in China was less than 3% of it (Yan, 2004), unmatchable with Chinese huge capability of production and exporting. Although, China has already awoken in the wave of globalization and come to realize the inevitability of participating in global competition, it is not enough and global sourcing has still broad development prospects and potential.

This Summarize the condition of Chinese corporations' participation as suppliers in global sourcing and analyze the potential risks, such as risk of holding inventory, risk of receivable accounts, the risk of capital locked up, risk of incomplete contracts and other risks such as non-tariff barriers and so on. And on the base, discuss countermeasures to them, such as giving the concept of extended cost and the procurement-supply sharing information system, forecast and contract protective terms, setting contract terms flexibly, scientific consideration of capital investment and so on.

ANALYSIS ON THE RISKS OF CHINESE CORPORATIONS' PARTICIPATION IN GLOBAL SOURCING AS SUPPLIERS

To reduce risks, the buyers put forward a variety of requirements to global suppliers which form the "game rules". Only comply with the rules, can you take part in the game, whereas, to some degree, these requirements increase suppliers' risks and uncertainty in turn.

Risk of holding inventory: The procurement enterprises shorten procurement lead time and implement "zero-inventory" which brings the following aspects of the risks to the supplier enterprises necessarily: First, increasing need of storage space and storage cost will occupy more operating capital; Second, the withdrawal from market of large funds will reduce the operational efficiency of capital which leads to a low rate of return. Last, the tangible and intangible loss of inventory is another potential risk. Well known to all, because of the acceleration of products replacement rate, inventory devaluation will become a big risk that the suppliers have to burden.

Risk of receivable accounts: Payment deadline lengthening win more funds available for the procurement enterprises in case of no increase in the absolute amount of funds. Meanwhile it brings only risks to suppliers. First, in the long term, the risk of exchange rate fluctuations becomes more possible and more severe. Second, in the international market, commodity price varies with the comparative relation of supply and demand and price fluctuations in the long term will be sharper. Last, this practice also greatly reduces funds available of the supply enterprises.

Risk of capital locked-up: Requiring suppliers to coordinate in requirements of services and products provides an effective resolution to reduce the risk of changes in market demand for procurement enterprises but partly convey the risk to suppliers. As a result of the smaller-volume-more-kinds market demand and shorter product life cycle, supplier enterprises have to burden the risk of an out-of proportion ratio of input and output in order to counteract to the fluctuations and changes. One is excessive inventory and fixed assets investment to meet peak demand of market, the other is excessive increase in technology research and development capabilities to meet the higher standards of products and services. It is very likely to cause predicament of capital locked up.

Risk of incomplete contracts and other risks such as non-tariff barriers and so on: This kind of risks are mainly caused by two reasons: One, in the case of not enough acquaintance with international trade, supplier enterprises are easily exposed to incomplete contract but lack of appropriate treatment measures; the other, the complicated trade procedures and various non-tariff barriers brings such enterprises more risks.

STUDY ON THE COUNTERMEASURES TO THE RISKS OF CHINESE CORPORATIONS' PARTICIPATION IN GLOBAL SOURCING AS SUPPLIERS

The extended concept of cost and procurement-supply sharing information system: To deal with the inventory risks, two angles can be taken to discuss.

Extended concept of cost: First, we should use a more scientific method to appraise cost. Only the cost of production and management overheads is concerned in Traditional costing method. In Equation, (1) C-cost; MC-material cost; LC-labor cost; OC-management overheads cost:

$$C = MC+LC+OC \tag{1}$$

This costing method is very popular, because it is easy to understand and calculate. However, it seems to neglect the cost of inventory loss cause by costumers' requirements which may probably account for a considerable part of the total cost.

To avoid the risk caused by inventory, at the beginning of cooperation, the suppliers should quote based on traditional costing and cost cause by procurement requirements. In doing so, calculate the cost needed by holding some level inventory as well, that is, except C derived according to traditional costing, it also includes: The storage cost caused by average level inventory, tangible/intangible losses and opportunity cost caused by the average occupying time of this part of capital, as in Equation, (2) Equation and (3) C-total cost without concern about opportunity cost; SC-storage cost; TLC-tangible loss cost; ILC-intangible loss cost, OC-opportunity cost of occupied capital:

$$C = C+SC+TLC+ILC \tag{2}$$

$$TC = C'+OC \tag{3}$$

With the more scientific costing method, the suppliers can calculate corresponding cost for each customer based on different requirements, then add reasonable profit to it, thus they can distinguish valuable customers more effectively, based on which make rational choice avoiding trading at a loss. (2) The two-parties-sharing information system: From the strategic height, to solve the inventory problem effectively, the root is the degree of confidence between the procurement and supplier enterprises, the level of cooperation and the application level of information system (Yang, 2005). The fierce market competition and the requirement of rapid response to demand, promote rapid prevalence of less-inventory or even "zero-inventory" and "Just-in-time". But, if the buyers think only about how to convey their own risks to suppliers, it is deformed and vicious competition. So, only finding some more reasonable supporting scheme, the current practice of "vendor-manage-inventory" could be carried out healthily. Because the inventory risks are mostly caused by fast delivery and the inaccurate transmitting of market demand fluctuations information, communication mode of both suppliers and buyers has become the focus of resolution. And this, in turn, depends largely on the strategy positioning relationship and the level of confidence between the two parties.

Having excellent relationship and confidence between the two parties, they can develop further information sharing system to eliminate unnecessary waste and provide better service and delivery time coordination for the buyer. And with the interrelated, integrated information sharing system, it is possible for the suppliers to offer a scheme to reduce the inventory risks to minimum fundamentally. All this need the two parties collaborate in hardware, management, technology and son on to build smooth information and logistic flow.

Forecast and contract protective terms: The receivable accounts of suppliers will bring enterprises the risks caused by fluctuations of exchange rate and price fluctuations and reduction of operating capitals, etc., To avoid or lessen the risks above as far as possible and handle the uncertainty brought by receivable accounts, the supplier enterprises can analyze from the following aspects and take responding countermeasures.

Exchange rate fluctuations: As a result of the imperfect exchange system and market, the risk of exchange rate fluctuations is everywhere. In order to avoid the profit loss of such kind, the suppliers should take measures in prevention and correction. Prevention strategy is to forecast the trend of exchange rate or choose the beneficial current in transactions after quantitative forecast of exchange rate trend and statistic analysis based on the study on the basic factors affecting the exchange rate, in terms of domestic macro economy trend, the global economic development and the trend in the future. The important factors to be analyzed are: economic growth rate, interest rate, inflation rate, balance of payment, government budget deficit, international political events, expectation of foreign exchange market, other speculative factors, etc. Correction strategy counteracts or avoids the risk of exchange rate fluctuations mainly through the use of some financial instruments. The commonly used ways are to hedge in the foreign exchange market and to set protective terms in purchase order such as floating exchange rate.

Price risk: The price fluctuations in the course of producing, delivery and payment, cause price risk. To avoid it, a similar method using floating price in purchase order can be used, that is, set terms saying that when the price fluctuation is beyond an agreed scope, a new price should be implemented. This method has similar characteristic to floating exchange rate that part of the risk can not be eliminated and the scope of tolerant price fluctuations is to be discussed by the suppliers and procurement enterprises.

Risk of operating capital loss: The payment is not conducted concurrently with the delivery but delayed, as a result, the net present value perhaps reduces which will lead to the reduction of operating capital during the internal between them. To avoid this kind of risk, the key is to try best to decrease the outflow of cash on base of the already postponed payment trade. One feasible way is to postponeits own suppliers' payment time to offset the risk of operating capital loss caused by payment delay.

However, in doing so, a vicious circle may be formed and the relationship between the buyers and the suppliers will be destroyed and perhaps cause bad quality and hidden trouble.

Scientific consideration of capital investment: The foremost dangerous risk is capital locked up. It places an enterprise an unfavorable and passive situation and has to go on business hardly. To reduce this kind of risk effectively, the suppliers should realize the great danger, understand the buyers' "balance" and consider the path dependency while making decisions. Make sure that a choice need of lots of capital should be made prudently after calculating the total cost and profit and considering carefully.

In addition, to realize that quantity is not the only criterion of customer's value. Those who bring considerable profit and profit margin and continuous business, are the most worthy of attention. Concerning only the purchase quantity likely induces enterprise "cancer". The management of Kingking corp. said, " Wal-Mart is our biggest customer at present, whose purchase amount is about 20% and in next step we will focus on the development of small and medium-sized customers"(Zhou, 2003), in order to avoid the absolute control.

Avoid other risks flexibly:

- **Standard contract to reduce risk:** While the purchase order negotiation, whether buyers or suppliers are striving for more interests for their own actively. In global sourcing, the supplier enterprises need deliberate and audit the terms in purchase order and take appropriate tactics to reduce the risk of purchase contracts. For example, put all the agreed terms into the contract as far as possible, use the standard model purchase contract, set protective terms in purchase contact and so on. Setting protective term is beneficial to both sides to properly solve uncertain problem without any disputes, especially to those with long span, payment in istallments or payment in lump sum in future

- **Handle non-tariff barriers:** Two types of non-tariff barriers are direct and indirect

The suppliers can take the following measures responding to direct non-tariff barriers: first, focus on collecting information and strengthen tracking studies on the quantitative restrictions on imports; sec, strengthen direct foreign investment to bypass the quantitative imports restrictions and other non-tariff barriers; last, study the import procedures and evade quantitative restrictions on imports flexibly.

In contrast, to handle the indirect non-tariff barriers, the first thing is to forge itself strictly and integrate with the international products standard which is also the premise that made-in-China develop market abroad; secondly, Chinese government and enterprises should analyze the trend of the development of foreign trade policy to China, the measures in implementation or elaboration related to foreign trade and set up the inform-and-quick-respond mechanism.

CONCLUSION

In the past 40 years, the rapid development of transport vehicles and information technology make the world smaller, as a result the international operation of enterprises become popular. Along with this trend, as one low-cost means of business develop, global sourcing absorbs more and more corporations' attention. Each industry in China will also face the various challenges and opportunities. However, most Chinese enterprises haven't make good preparation for it and have no enough knowledge about it, so the status at present is not the result of rational development but the result of "learning by doing". We discuss global sourcing and study on it so as to make Chinese enterprises have a scientific understanding of the current situation and make decision prudently. It is the key to win in the new market.

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