

Working Title: "China Sourcing Success/Failure Factors" Mike Bellamy Rev 2.19.2008

The single most important factor in determining the success or failure of your sourcing program will be finding the right supplier. It sounds obvious, but making apples-to-apples comparisons of vendors at a national level can be daunting. The following article is a behind the scenes look at a how PassageMaker assists its clients find vendors in China. This system outlined below is based on the company's 10 years of experience in China and 1000's of sourcing programs. Having outlined how to conduct a professional supplier identification program, the second half of the article will focus on the costs involved and options for conducting such a program.

I. Finding the "right supplier"

Your sourcing feasibility study / supplier identification research should have a clear methodology for **defining** and **measuring** the desired attributes of the ideal supplier.

Step One "Defining": The "right supplier" is unique to each buyer, as the relative weight placed on price, quality, lead time and other attributes differs from project to project. Below is an attribute survey template used to transfer this information from buyer to research team. A sample project is attached at the end of this article for reference.

Rank	Common Key Attributes						Other Desired Attributes				
	Price	Quality	Security	Location	Capacity	Service Attitude					
1 to 10											
Explanation:			Protection of IP / Non-competitor	near a specific port, for example			such as experience with a certain technology or material, or UL certified, or possess in-house tool and die shop...				

Step Two "Measuring": At PassageMaker a typical supplier identification research project takes 30-45 working days assuming multiple components and production methods need to be explored, at a national level. The process is as follows:

- ✓ Initial research generates a list of 50-100 potential suppliers using web directories like www.GlobalSources.com and industry/trade show directories. At PassageMaker, the Approved Vendor List (AVL) can be consulted to see if any known suppliers should be added to the list.

Insider Tips:

1. Assume the vendor is a middleman until proven otherwise, not the other way around.
2. Avoid factories that refuse to list the name or location of the production facility. If they only show a HK, Taiwan or other non-PRC address, then they probably don't own the PRC factory and are a middleman of some sort.
3. Focus on those factories that can clearly show production experience with your particular product or production method.

4. *Be aware that polished English skills do not reflect production skills. Often the most polished websites are set up by trading companies.*
 5. *Look for clear information about operation size, equipment and staffing.*
- Visit <http://www.psschina.com/articles.htm> for related articles on avoiding middlemen in China.
- ✓ Review the 50-100 candidates' websites and brochures against client's desired attribute list and narrow the field down to 15 to 20 candidates. At this point, "first contact" is initiated in the follow ways:
 1. Send an e-mail or make a phone call to ask for initial product-specific information (price, minimum order size, lead time).
 2. Are samples available? If they don't have samples readily available, they probably don't deal in your product on a regular basis.
 3. Granted the sales team will be the most polished in terms of English skills, but how is their understanding of your basic requests? If you ask for information on a red umbrella and get sent a sample of a blue shoe, you are going to have problems with communication down the road!
 4. Confirm the actual production location and ask for ownership papers of the factory. Be explicit that the production location may be audited and that this location can not be changed w/out approval of buyer. (You would be surprised at the number of middlemen who will take the buyer on a visit of a factory only to change the location to a less expensive and poorer quality option after the buyer leaves)
 - ✓ The above research should narrow the field down to about 5 highly qualified candidates. At this stage, PassageMaker QC engineers and Sourcing Managers (joined by the client when possible) visit the factories in person to review quality systems, confirm production methods, negotiate pricing and look for any red flags. In other words, visit the production facility to confirm the information given during the initial research was accurate and truthful. This is an essential yet often overlooked step by those looking to cut corners during research. Unfortunately, due to the massive number of trading companies and aggressive China sales staff who will say almost anything to get your business, visiting the production line in person (or via your appointed representative) is the only way to confirm the real situation.
 - ✓ Based on the results of the factory visits, the next phase is sampling, trial order or even Purchase Order placement with the top vendor or two.

(Visit <http://www.psschina.com/articles.htm> for related articles on Negotiation and Vendor Coordination)

II. Options/Costs for Conducting Supplier Research

When looking to source in China, you have a number of options with various costs involved at your disposal. Below is a behind the scenes look at the pros and cons of each option.

1. Do it yourself

Thanks to free and easy-to-use websites like Global Sources, generating a list of potential vendors has never been easier. But make sure you have the time, engineering and China sourcing experience to narrow a massive pool of vendors down to a handful of highly qualified vendors. Simply picking the first 3 vendors that come up on an internet search is highly unlikely to uncover the best match for your particular requirements. If for budgetary reasons you are forced to DIY, we hope the above outline and tips will get you pointed in the right direction.

2. Engage an intermediary (trading company, sourcing agent or factory representative...) to conduct this research on your behalf.

It is worth paying for professional research if you don't have the time and China experience to conduct the supplier identification research on your own. There are 3 common methods used in China to invoice for the initial supplier research:

- ✓ Charge a % of the future PO value. Generally 5 to 15%. While this is an easy to calculate figure, unfortunately there is no incentive for the research partner to keep costs low. Actually the incentive is to steer the buyer toward the most expensive sourcing option.
- ✓ Invoice a set research fee. At PassageMaker for example, a fee of a few thousand USD is charged per production classification researched. This fee is refunded to clients should they utilize PassageMaker for on-going services such as vendor coordination or inspection services (visit www.psschina.com for details).
- ✓ "For Free". Some companies will offer to conduct the initial supplier identification for free. However, while it sounds the most attractive at first, nothing is done for free in China and quite often the "for free" model is the most expensive in the long run. As mentioned above, our team of experienced sourcing engineers will require 30-45 days and spend 100's of man hours, leveraging years of China sourcing experience to narrow this list from 100's of choices down to the top candidates. If somebody offers to "do it for free" this is what may be really happening:
 - a. They will decide which sub-suppliers to use. That means they may select the supplier which is best for them, not best for you. Perhaps where they have a relative, kickback or commission. In effect the buyer is getting steered towards a supplier which may not be the best match for the buyer's specific requirements.
 - b. "You get what you pay for". They don't plan to conduct in-depth research on a national level. If someone is providing research for free, they may not be as conscientious about understanding your goals and helping to find the right supplier. Keep in mind that finding the right supplier is the single most important factor in determining if your project will succeed or fail.
 - c. They plan to cover the internal costs of the initial research by charging you an inflated per-unit cost once production starts. In the long run, the buyer pays too much.

Insider Tip: If your "partner" is unwilling to state the name of the sub-suppliers and give the pricing points, then you are certainly paying too much. Furthermore, if they do not disclose the actual

manufacturer, then you have no way to validate the quality process in place and you have lost control over who has access to your intellectual property.

Unfortunately, even if you pay a company in China to conduct this supplier research you can't automatically assume they are looking out for your best interests. (Visit http://www.psschina.com/pricing_scams.htm for more information on common pricing scams.) It is common in China for trading companies to milk both ends, in other words charge the buyer for a research fee or commission while getting a kick back or other commission from the supplier. Therefore, you must perform due diligence on your research partners as well.

When considering a research partner in China, make sure you ask about ownership, compensation structure, client references, non-compete clauses, research methodology, full disclosure of sub-supplier pricing and identity, company history, warranty terms and the plan for protecting your intellectual property. At PassageMaker for example, by paying a research fee you can rest assured that we take the project seriously and will review each and every detail to ensure your goals are met. We fully understand the importance of trust and transparency, and when we are hired for supplier identification research we offer total disclosure of the above information in our contract, so it's absolutely clear where compensation comes from and that our interests are 100% aligned with the buyer. Should you pay for research in China, make sure you have such a contract in place. If your "partner" is doing the research for free, then they are not obligated to do a professional job.

Attachments:

Introduction to the author

Sample Attribute Chart

Introduction to the author

For the past decade Mike Bellamy has been based full-time in Asia. Fed up with the inability of middlemen/ trading companies to control quality and tired of having intellectual property (IP) knocked off, he decided to do something about it by forming PassageMaker in 2002. Mike developed a system to extract the best pricing in China and protect IP without compromising quality and service. PassageMaker's 100% US owned and operated Assembly Center in S. China serves as the client's "black box" where inspection, final assembly and branding takes place behind closed doors. In this fashion, Intellectual Property is physically secured and full quality inspection is conducted before product leaves China. Mike has structured sourcing investments in over 150 production classifications for US and European clients during his time in China. He has an International MBA from the University of South Carolina, which included course work in Harbin and Beijing.

Recognized as expert on China sourcing, Mike is has been a featured presenter for Global Sources Asia Expo HK, Global Sources Dubai, Boat Tech China, Rotary Foundation, US Chamber of Commerce, British Chamber of Commerce and State Bar of California among others. A former Rotary Foundation Ambassadorial Scholar, Mike speaks Chinese and Japanese, and is based full time in Shenzhen China.

Learn more about Mike (MikeB@PSSchina.com) and PassageMaker at www.PSSchina.com. This website includes free educational material such as sourcing seminar videos and tools of the trade.

Sample attribute chart

Background: Classroom Chalk supplied in hand held buckets

Common Key Attributes							Other Desired Attributes					
Rank	Price	Quality	Security	Location	Capacity	Service Attitude	Non Toxic	Packaging				
1 to 10	9	7	10	6	10	6	10	9				

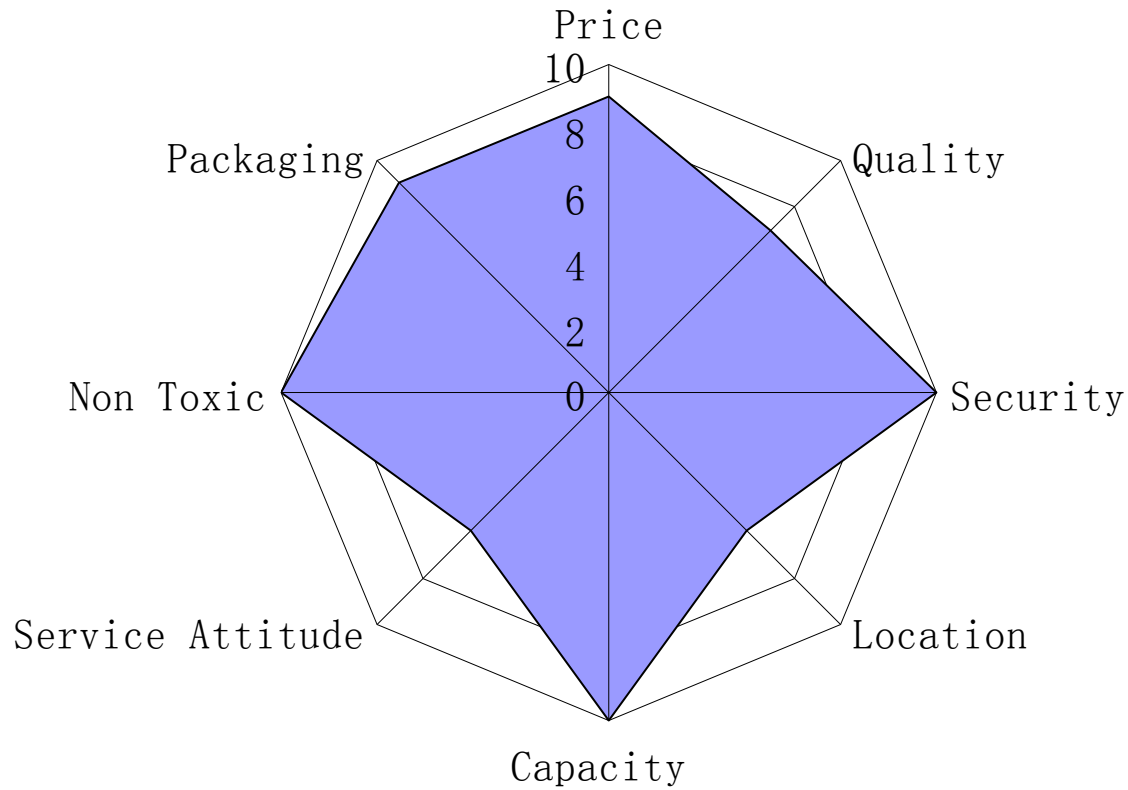
Common Attributes Key Client Notes

Price	competing on price in market
Quality	price is more important than quality for this classroom use product
Security	we do not want the Chinese suppliers to be aware of end users
Location	it would be nice to be near a port, closer to port = less travel = less breakage
Capacity	buying in very large quantities, factory must be prepared
Service Attitude	we want to be a big order for a medium sized factory, this way they take us seriously

Other Attributes Desired Client Notes

Non-toxic	must provide lab testing of heavy metals
Packaging	looking for hand held plastic buckets, cardboard box may be acceptable

Relative Weighting of Key Attributes



With written approval from the author you are welcome to reprint and publish this article.