

# Managing China Supply Chains is Very Different Than in the West

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For every successful sourcing experience in China, there is more than one disappointment or complete failure. Successful supply chain management in China is very different than in the West. Companies that don't understand and adjust to the differences invite problems. Countless high quality products that enrich our lives are built in and/or sourced from China every day. Chinese exports range from the lowest tech toys to the highest technology computer electronics. So, the question is "why are some companies so successful managing China supply chains, while others are not?"

## A Balanced Look at the China Supply Chain

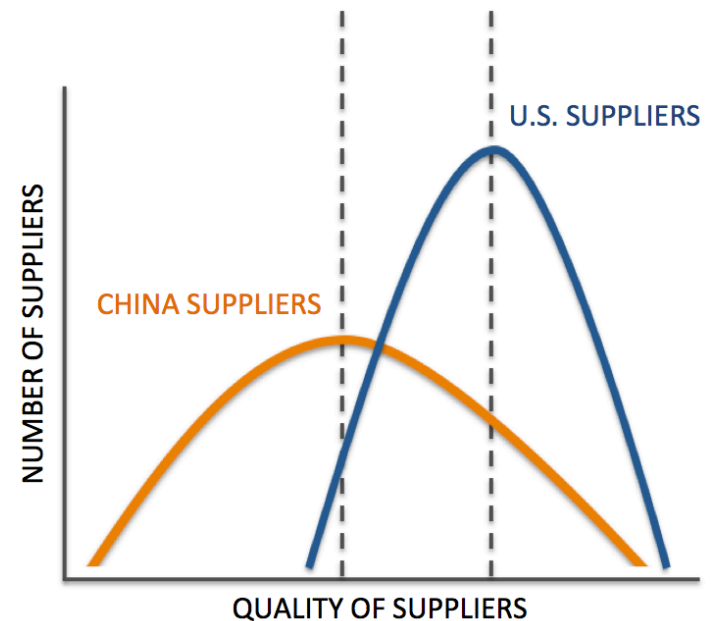
At the most fundamental level, China's commercial environment is young. China has been engaged deeply in Western-like commerce for little more than two decades. The principles that Western business people take for granted are not ingrained throughout China business yet. Simple "rules" don't have the same intuitive acceptance in China as in the West, such as not substituting materials in customer-specified products without prior approval. Companies that try to manage suppliers without understanding these many differences almost inevitably encounter disappointment. Decoding the differences is not an insurmountable challenge but it takes patience, curiosity and a disciplined approach to supply chain management.

Suppliers as capable as the best in the West can be found in China. At the same time, China suppliers who could not find a customer in the West because of their substandard quality can still survive in some segments of the China market. How can this paradox coexist in today's global and increasingly transparent market place? In the West, the absolute quality difference between excellent and poor suppliers is actually pretty small. Our fixation on continuous improvement drives acceptable quality

standards in a positive trajectory and the competitive environment has eliminated suppliers who don't keep pace.

The graphic below conceptually depicts the basic difference between the developed Western and evolving China supply chain environments. Excellent suppliers exist in both worlds. The average quality level in the West is higher and no poor quality suppliers can survive. In China, the continuing demand from the state-owned industrial segment where quality standards are often (not always) lower than Western norms, provides Chinese suppliers with a market for lower quality products. The challenge for Western companies seeking suppliers in China is to connect with suppliers that are aligned with Western quality expectations. Chasing low prices exclusively is almost never the right approach to assure quality compliance.

## The China Quality Challenge



## Four Keys to China Supply Chain Success

Based on decades of China supply chain management experience, China Centric Associates has learned that there are four keys to success. Get these four key actions right and the chances of supply chain success in China are greatly enhanced:

1. Execute an effective supplier qualification process;

2. Invest the time and effort before placing the first order to assure synchronization of understanding in all aspects of supplier-customer “rules of engagement”;
3. Refine and adjust routine supply chain management processes to the differences in the China supply chain environment; and
4. Continually test alternative supplier options and challenge existing suppliers to improve operationally – cost, delivery, and quality.

### Supplier Qualification

Effective supplier qualification in China is more than checking product samples, equipment and quality documentation. It is assessing a supplier’s management and process stability to ensure that the supplier selected can consistently meet the requirements including product, total cost of product acquisition, quality, and logistics. If the buy is a strategic on-going need, the goal should be to select a sustainable supply chain partner and not just chase the lowest price product.

For example, Chinese suppliers know that Western customers expect to see control charts, work instructions, and visual indicators on the factory floor, demonstrating a commitment to statistical process control. However, a most Chinese companies do not understand the importance of these tools. SPC charts are often filed with no closed loop management discipline to control operations. A disciplined supplier qualification digs deep into process management identifying strengths and weaknesses in supplier processes that are often the determinants of actual long-term success.

Understanding supplier strengths and weaknesses is a predictor of sustained product, quality, delivery and communications performance. A well-structured Supplier Qualification process assesses suppliers across six functional disciplines:

1. Manufacturing Facility and Process Equipment;
2. Manufacturing Management Processes;
3. Quality Systems;
4. Technical Support;
5. Logistics and Export Capabilities; and
6. General Management and Finance.

The #1 key to China supply chain success is executing a comprehensive supplier evaluation that is sensitive to the China supply chain environment.

### Contracts – Synchronize Expectations

The 2<sup>nd</sup> key to China supply chain success is synchronizing the understanding of all customer-supplier “rules of engagement” from the outset of the supply relationship. The importance of this action cannot be overstated. Innocent mismatches of expectations between Western customers and Chinese suppliers about Western commercial principles are extremely common. If you engage a Chinese supplier assuming they intuitively understand how suppliers and customers interact in the West, you are taking a big risk. Simply sending a purchase order to a Chinese supplier may work for commodity-like buys, but for any non-trivial products, using purchase orders alone is a risky path. The more strategic the buy, the more critical it is to assure that your Chinese supplier understands clearly all requirements of the supply relationship.

It is recommended that formal supply contracts be established with suppliers that is more comprehensive than we would use in the West. It needs to define all possible “rules of engagement,” including but not limited to product specifications, quality assurance requirements, terms and conditions of sale, intellectual property considerations, stocking programs, and non-compete provisions. Investing the time before actual purchases avoids problems later. In combination with disciplined supplier qualifications, a complete supply contract sets a sound foundation of transparent understanding and expectation between customers and China suppliers.

### Refine Western Supply Chain Management Processes for Application in China

The 3<sup>rd</sup> key to China supply chain success is refining your company’s routine Western supplier management processes to China realities. These processes work effectively in the West, but they are almost always mismatched for use in China. In the West, we expect “arm’s length” accountability for supply consistency and compliance across all requirements. We expect our Western suppliers to manage these requirements with a minimum of active intervention by us. China will someday reach that same developed state, but the China supply chain is currently far from being that developed.

A high-profile Western toy company damaged their reputation – perhaps irreparably by mismanaging their Chinese suppliers. After over twenty years of seemingly

problem-free imports of high quality toys, this company relaxed or lost their supplier quality assurance discipline and suppliers began to use lead paint, which failed to meet Western consumer safety standards. The Western company not only lost financially and damaged their consumer reputation; the CEO was forced to admit publicly that the problem was not with the Chinese suppliers, but came from failures in the company's own documentation, designs and management processes.

Chinese suppliers' sophistication in manufacturing processes, such as quality assurance, material management, and manufacturing engineering, lag the West. These processes have taken generations to develop in the West and that process is still "in-progress" in China, which presents unique challenges.

It is wise for Western companies sourcing in China to exercise routine mentoring and monitoring of supplier performance because of the relatively unsophisticated nature of many Chinese suppliers. This means visiting suppliers, performing periodic requalification audits, and implementing on-site quality assurance programs or inspections at least annually, but preferably more frequently. Any company can get the first order right when all eyes are focused on it. It takes systemic stability of supplier production and management processes to turn start-up success into long term supply performance.

### **Continually Test and Adjust a China Supplier Base**

The 4<sup>th</sup> key to China supply chain success is to continuously test and adjust the China supplier base. In the West, supply chain professionals are constantly scanning the general supply base, searching for new suppliers and options in a dynamic environment to optimize performance. It is surprising to me how many companies abandon this practice when sourcing from China. Companies find a supplier and then stick with that supplier for years with little or no investigation of alternatives. The same discipline exercised to continuously optimize supply chain performance in the West needs to be exercised in China. In fact, because the China supply base is more dynamic, it is arguably more important.

Cost changes in and immediately around major cities like Shanghai, Guangzhou, Shenzhen and Beijing present challenges for Western companies who were able to find qualified suppliers years ago. The movement of the axis of industrial development into secondary cities further west

and the rapid enhancement of the technology base and work force experience expands the options available.

To sustain and improve China supply chain performance requires an on-going focus on monitoring the dynamic supply chain environment in China, scanning for better suppliers delivering improved total value. Passive satisfaction with existing suppliers is not an effective way to assure the best supply chain performance.

### **Disciplined China Supply Chain Management Revisited**

Back to our initial question -- "*why are some companies so successful managing China supply chains, while others are not?*" The simplest answer is that companies that succeed in China understand they need to adjust and that practices that work in the West need to be refined when working in China. Supply chain success in China is no more difficult than anywhere else in the world, as long as the company understands and follows the four keys to China supply chain success discussed in this paper. There are no short cuts to success!