

# Supply Chain Globalization

Global strategies that go beyond the basics





**S**upply chain globalization is the natural outcome of today's expanding consumer markets as companies struggle to meet the dynamic needs of growing markets and new consumer segments. Despite the risks caused by economic and political uncertainties, global supply chains are the wave of the future. Companies that make key decisions early—about entering new markets, balancing risks and opportunities, and managing costs and complexity—are more apt to remain leaders in their industries.

The pace of globalization continues to foster opportunities, challenges and uncertainties for companies around the world. World exports grew more than twice as fast as world GDP growth from 2000 to 2006; the trend is consistent across all regions and industries.<sup>1</sup> Six of the top 10 destinations for retail investments in 2007, and three of the top 10 destinations for heavy manufacturing, were not on the list in 2003.<sup>2</sup> New consumer segments are emerging as promising revenue opportunities, with medium- to low-income consumers now comprising three-fourths of the world's population.

Economic and political developments continue to pose challenges for global supply chains. With the value of the U.S. dollar at its lowest in a decade, there is more demand for cheaper U.S. imports, particularly in growing economies such as China, India, the Middle

East and Russia. At the same time, a shift to more protectionist trade policies by the United States could spur retaliatory actions from foreign countries, while U.S. corporations become attractive investment buyout targets for sovereign wealth funds from countries such as China, Saudi Arabia and the United Arab Emirates. This trend may be accelerated further with the current financial sector crisis in the United States. Although the resolution path is unclear, one thing is apparent—economies are more interconnected than ever before and any policy shift will have an impact on the flow of investment and ultimately on the way companies conduct business around the world.

Today, as never before, companies are struggling to design more efficient supply chains that can manage the complexities of globalization—and withstand the effects of unknown and

<sup>1</sup> *International trade statistics, World Trade Organization, 2007.*

<sup>2</sup> *2007 A.T. Kearney Global Retail Development Index; 2007 A.T. Kearney Foreign Direct Investment Confidence Index.*

unpredictable risks (see sidebar: *Risks to Both Sides of the Global Supply Chain*).

It is within this vortex of challenges that many companies are discovering opportunities. By implementing supply chain globalization strategies—particularly those designed to meet the unique needs and demands of global consumers—companies are discovering new ways to grow and prosper.

### Meeting the Demands of Global Consumers

Between 2003 and 2007, six nations entered the ranks of the world’s top 10 destinations for retail investment (see figure 1). The order among the top four nations—India, Russia, China and

Vietnam—was shuffled somewhat as India moved from fifth to first; Russia from first to second; China stayed in third; and Vietnam moved from ninth to fourth.

Pushed upward by rising living standards and burgeoning populations, more than 75 percent of the world’s citizens is composed of “medium-low-income” consumers. With purchasing power parity of up to \$10,000, they constitute the majority in Eastern Europe, the Middle East and Central Asia.

Making products affordable for this market requires a low-margin, high-volume strategy and the efficient use of relatively modest amounts of working capital.

One approach companies employ to attract these customers is to reduce packaging size and thus reduce the price per unit. For example, in India, Hindustan Unilever sells five billion pieces of penny candy a year, earning revenues of \$50 million. Another successful technique is to aggregate customers, especially if products cannot be disaggregated. For example, in Mexico, Cemex helped group poor families together into communities with joint responsibility for making weekly house payments.

Yet another strategy is to recognize and serve the unique needs of a large, untapped and growing subsegment of an existing market. We can use the Muslim market to illustrate this point. By 2020, Muslims will account for 30 percent of the world’s population, compared to 20 percent today, and 12 percent of global consumption, up from 8 percent today. Muslim consumers are not just in Muslim countries but are spread across the world, with more than half in Asia. Even the U.S. Muslim market, small by comparison, represents \$107 billion in spending power. Sharia and Halal compliance is important to Muslim consumers, yet only a small amount of this \$560 billion market is being addressed by major multinational companies.

**Figure 1**  
New destinations for global investment in retail

Country destinations (retail)	2007 rank	2003 rank	Movement
India	1	5	+4
Russia	2	1	-1
China	3	3	–
Vietnam	4	9	+5
Ukraine	5	–	New
Chile	6	–	New
Latvia	7	–	New
Malaysia	8	–	New
Mexico	9	–	New
Saudia Arabia	10	–	New

Significant upward movement
  Upward movement
  No change
  Downward movement

Sources: 2003 and 2007 A.T. Kearney Global Retail Development Index; 2003 and 2007 A.T. Kearney Foreign Direct Investment Confidence Index; A.T. Kearney analysis

Serving a subsegment of an existing market requires redesigning business processes, which, in most cases, affects the entire value chain—from R&D and sales to marketing and distribution.

### Supply Chain Globalization Can Be Successful, If...

From our work in supply chain design, implementation and management, we believe a successful supply chain globalization strategy depends on the following:

**Understanding the global landscape and identifying real opportunities.** It is not enough to understand the global landscape; companies

must also have a plan in place for recognizing when to enter a new market and how to capture emerging opportunities (*see figure 2 on page 4*). For example, Carrefour Group operates 15,000 stores in 30 countries in Europe, Latin America and Asia, using four formats: hypermarkets, supermarkets, hard discount and convenience stores. Carrefour was early to recognize the potential of the “greenfield” Chinese market. It entered China in 1995 and by 2006, its 112 Chinese hypermarkets and 275 discount stores reported annual sales of approximately \$4.5 billion. Today it is the only foreign retailer among China’s top 10. In contrast, Tesco, a competing international

## Risks to Both Sides of the Global Supply Chain

Supply chains are increasingly vulnerable to an imposing array of risks with significant consequences to both demand and supply. The following are recent events that underscore the possible severity and unpredictability of global supply chains.

**Supply shortages.** Between 1996 and 2006, acreage dedicated to hops fell 30 percent as farmers planted more corn to satisfy the meteoric demand for ethanol. The shortage of hops—a key ingredient in beer production—forced brewers to enter into longer term contracts as a hedge against increasing prices.

**Raw material price increases.** Aluminum represents 15 percent of Coca-Cola’s production costs and 20 percent of Pepsi’s production costs. Aluminum price per ingot on the U.S. spot market has increased 83

percent since 2003 due to high power costs that caused a decrease in production and a continued increase in global demand. Another example is the current increase in fuel prices.

**Natural disasters.** Recent earthquakes in China disrupted power, water, telecom and other utilities to the Chengdu area of Sichuan province, which offers high-tech manufacturers a lower cost alternative to the Shanghai coastal region. Intel and Motorola have facilities in Chengdu and were affected, as were companies in other industries including aerospace, aluminum, chemicals, cutting tools, fertilizer, machinery and metallurgy.

**Geopolitics.** Recent rebel attacks on Nigerian petroleum fields adversely affected domestic oil production and distribution. Any dis-

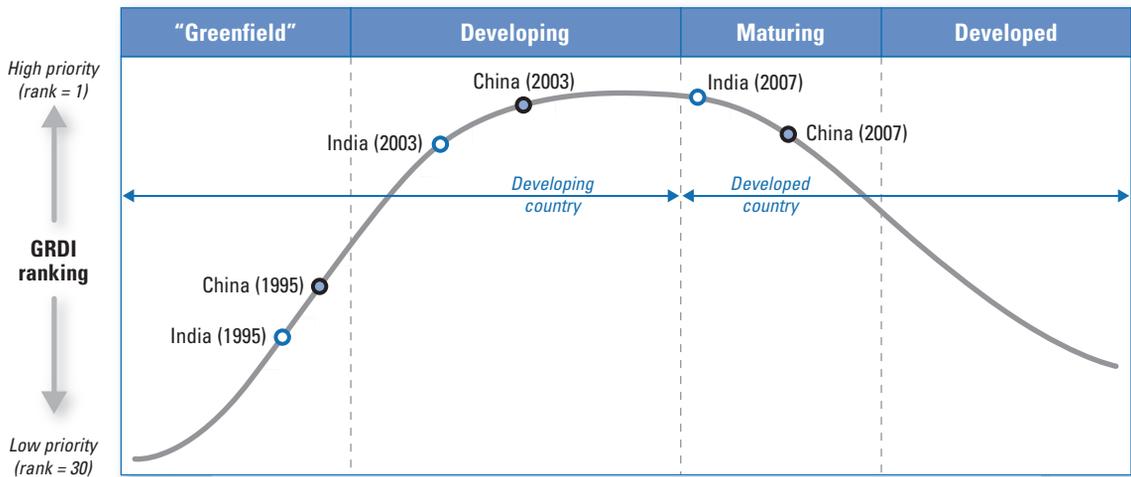
ruption in Nigeria—one of 13 OPEC countries—could have a ripple effect on worldwide oil supply and prices.

### Supply chain choke points.

With the volume of ships going through the Panama Canal at three times its planned capacity, there is the potential for lengthy or indefinite delays in passage. In addition, deforestation of the surrounding rain forests could reduce the water level in a lake feeding the canal, causing further delays.

**Quality.** Contaminated pet food and toys containing lead recently imported from China illustrate the unforeseen risks inherent in extended supply chains. A lack of appropriate controls at production sites increases the risk.

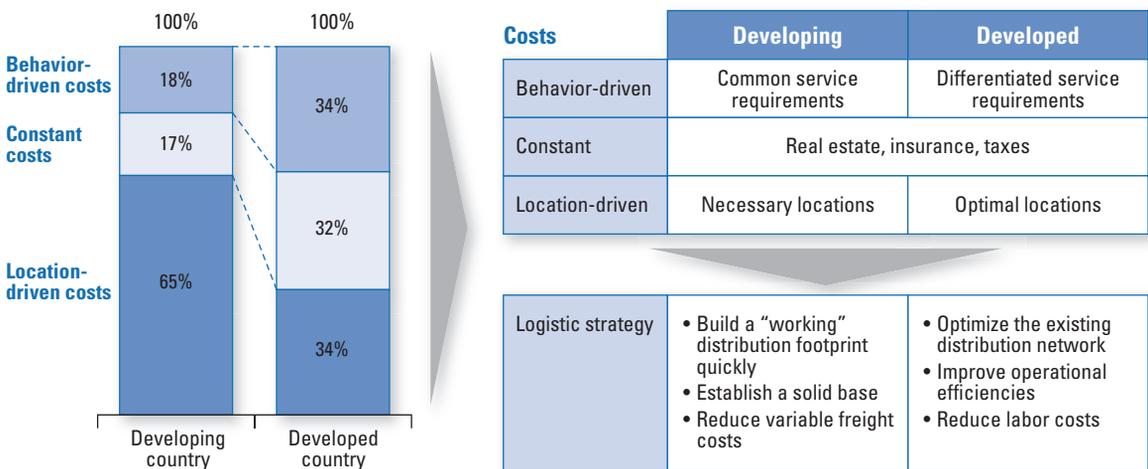
**Figure 2**  
Recognize opportunities early



Sources: A.T. Kearney Global Retail Development Index, 2007; A.T. Kearney analysis

**Figure 3**  
Supply chain approach is tailored for the market

Logistics example



Sources: A.T. Kearney analysis; client example from Asia-Pacific region

grocer, was slow to enter China's developing market. Entering in 2004, Tesco's sales in 56 hypermarkets were approximately \$1.1 billion by 2006.

**Balancing risks and rewards.** Doing business in global markets requires balancing risks and costs against potential benefits. Managing global price and supply risks with hedges are not limited to certain industries or spending categories. For example, the metals industry has used hedging tactics for over a century to address price volatility, a practice now being adopted by consumer packaged goods companies. Sara Lee hired former day traders to watch and hedge the price and supply of pork, which is a key ingredient in many of its products. Oil prices continue to be volatile, and uncertainty around global supply capacity and reserve levels will sustain this volatility for some time (*see sidebar: Are Rising Fuel Prices Throwing Globalization into Reverse?*). In the airline industry, Southwest

Airlines has effectively hedged jet fuel prices to reduce earnings volatility and improve margins. Winners of supply chain globalization are not afraid of this volatility, but rather embrace it and get ahead of it.

**Maintaining flexibility.** As mentioned earlier, every segment of the supply chain must be flexible enough to shift quickly to identify and capture new opportunities. And every potential opportunity must be measured against a matrix of quantitative and qualitative factors—from local tax and regulatory costs to labor force availability to freight costs to the economic and political risks within the market's national boundaries. Although supply chain principles can be pretty basic, execution strategies are not—they often involve navigating through the complexities of the global supply chain in areas of sourcing, manufacturing and delivering across geographies. Figure 3 illustrates some of the

## Are Rising Fuel Prices Throwing Globalization into Reverse?

A look at recent headlines would suggest some truth to the notion of a supply chain globalization reversal. Are companies staying local to avoid high fuel prices?

*The New York Times* reports that Tesla Motors, a pioneer in electric-powered cars, had a global supply chain in mind when it set out to make a luxury roadster for the American market. But the company decided to make the batteries and assemble the cars near its home base in California to cut more than 5,000

miles from the shipping bill for each vehicle. Rising transportation costs are also revitalizing the U.S. furniture industry as more wood is going to traditional domestic furniture-making centers in North Carolina and Virginia rather than being shipped for production in Asia.<sup>3</sup>

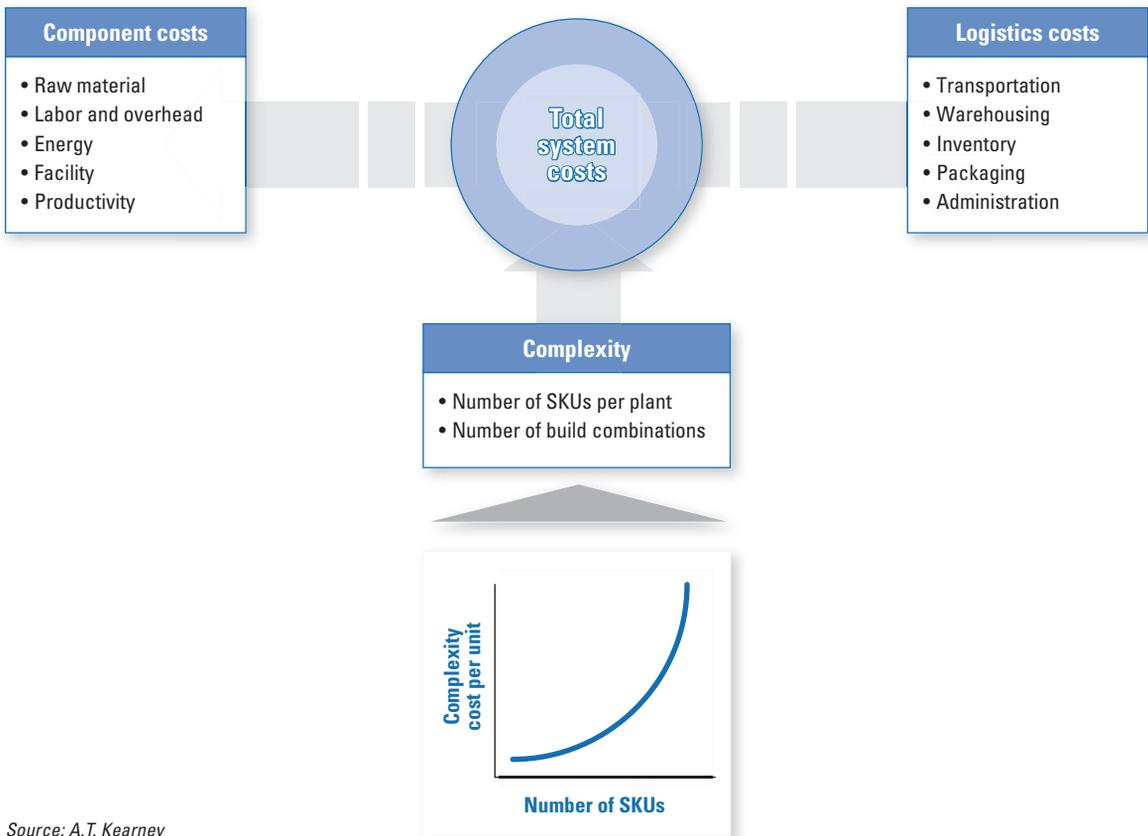
Although these actions make sense in the near-term, they do not portend the end of supply chain globalization. In our view, the point is not globalization versus localization but that companies are think-

ing of (a) improving capabilities by building alternative production and procurement sources, and (b) transporting goods more efficiently and innovatively, such as sourcing components globally and assembling them near-shore or on-shore.

Companies with flexible supply chains and IT organizations are able to take advantage of new opportunities. This will hold true today as fuel costs rise and in the future as alternative fuel sources become more viable.

<sup>3</sup> Larry Rohter, "Shipping Costs Start to Crimp Globalization," *The New York Times*, 3 August 2008.

**Figure 4**  
Managing end-to-end costs and complexity



Source: A.T. Kearney

differences in logistics. In developing markets, logistics has to be up and running quickly, while in developed markets companies are more focused on optimizing an existing network.

**Managing costs and complexity.** Cost visibility is imperative for companies operating across borders. They must be aware of what drives supply chain costs within each function and then tailor the overall supply chain strategy to achieve success in each market. When all costs are visible across the global supply chain, the company is in a better posi-

tion to accurately assess and evaluate the impact of possible trade-offs. Figure 4 highlights how total system costs are calculated, including the cost of complexity in components and logistics.

### Is Your IT Organization Ready for Globalization?

A global supply chain cannot be truly successful unless it is built on a solid foundation that allows for speed, flexibility, scalability, integration and accommodating the end-user experience. In other

words, success depends on IT capabilities that are “built to evolve.” Not only must the IT function allow the company to ramp up or down as dictated by market needs, but also enable inter-regional planning and visibility around the globe, and accommodate end-users’ needs with respect to roles, languages and security.

An exemplary global supply chain has an IT organization with the following characteristics:

**Embraces “lite” versions of IT solutions.**

A typical IT solution is often too “heavy” for companies operating in emerging markets. Traditional IT solutions were built to meet the legacy requirements of mature markets, and thus can be cost prohibitive both in setup and maintenance when deployed in emerging markets.

**Can scale up or down quickly.** In rapidly growing markets, where the business trajectory can sometimes make a constrained IT solution obsolete, it is imperative for IT to have the flexibility to scale up quickly. Conversely, scaling down the IT function is often required in new, early growth stage markets.

**Supports local requirements.** Local regulations, languages and ownership structures (such as joint ventures and alliances) can vary from country to country. Thus, the IT organiza-

tion must provide solutions that are adaptable and can support local requirements.

**Integrates complex inter-regional requirements.** As a supply chain goes global, business requirements evolve to include the need for global sales and operations planning, inter-regional order and logistics management and cross-currency financial transactions. IT solutions that lack these capabilities can impede the supply chain.

**Hires and retains outstanding people.** The ability to combine IT knowledge with a deep understanding of the supply chain function is essential. Although there is no shortage of IT talent in software and applications development, especially in offshore markets, there is a shortage of people with the knowledge and experience to partner IT knowledge with supply chain insight.

## Build an Optimal Global Strategy

Effective supply chain globalization can meet the dynamic needs of new markets and new consumer segments despite the risks caused by economic and political uncertainties. As the competition to take advantage of these various opportunities intensifies, an optimal global supply chain strategy—via a nimble IT function—can provide any company with a significant competitive advantage.

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