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CONSUMER MARKETS

Product Sourcing in Asia Pacific

New locations, extended value chains

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Contents

Introduction

Nick Debnam
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Consumer Markets
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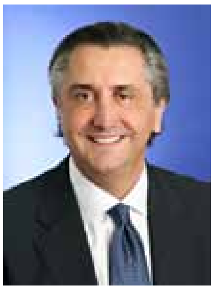

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Product sourcing is about striking a balance between speed, quality, and pricing, to meet the exacting demands of consumers.

It is a fascinating business and we are at a decisive time in the history of sourcing. The executives we have spoken to share a passion for their vocation and an awareness that we may be at a turning point, which requires dramatic changes to strategies and business models.

While many hard goods, ranging from consumer electronics to furniture, are still being sourced overwhelmingly from China, apparel and footwear production is widely dispersed and more mobile. Preferential trade terms have boosted exports from Cambodia and Bangladesh to the European Union (and also to China due to recent agreements between Bangladesh and China), while Indonesia has tended to be a more popular sourcing destination for Japanese and North American buyers.

Countries in South and Southeast Asia should continue to attract interest as China relinquishes its position as the world's manufacturer of low-cost goods. With minimum wage levels up to four times higher than those in other parts of South and Southeast Asia, China can no longer compete on a low-wage basis, although evidently it can still defend its position in many categories where it maintains an edge through productivity and the reliability of its infrastructure.

What do we see happening next? Will hard goods production start to shift and disperse as well? There are some signs that this migration is already occurring and many examples of specialist production and clustering in other parts of the region (for example, footwear in Vietnam and Indonesia, and hand-stitched fabrics and metalware in India). While no other single country can match the scale of China, countries such as Bangladesh have large low-wage workforces that are only starting to be harnessed, while the nations of Southeast Asia are exploring greater collaboration and breaking down tariff and customs restrictions.

The economic pressures facing producers are not unique to China; many other countries are seeing a tightening of supply. Wages are rising across the region, and many Asian currencies have strengthened markedly against the euro and the US dollar over the past two years. Meanwhile the higher costs of shipment and the demands for ethical, sustainable production are contributing to the need for entirely new thinking around sourcing models.

The executives we spoke to are formulating a number of responses to these challenges. These include stepping up design and innovation capabilities, selecting and partnering with suppliers more systematically, and using sustainability as a lens to drive their cost reduction and marketing activities.

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Mike Hurle
The main author and editor of this report, Mike is a Senior Manager with KPMG in Hong Kong.

Executive summary

1. Rising costs and a tightening labour market are leading global Consumer Markets executives to reassess their sourcing strategies and explore new locations across Asia. China remains the leading exporter of textiles, footwear and many hard goods; yet while the country has largely bounced back from the export slowdown of 2009, other large Asian markets such as India, Bangladesh and Indonesia are taking a growing share.

2. The increasingly complex requirements of supporting supply chains mean that established sourcing locations, including those in China, will still have an advantage in certain product categories. Many sourcing executives recognise that they must accept and manage their continued reliance on China through closer collaboration and automation.

3. Based on our discussions with executives, it is clear that some sourcing activity has moved closer to end markets over the past three years driven by high transportation costs, concerns over further carbon taxes, and the development of centralised approaches to inventory. However, the overall volumes sourced from Asia are unlikely to diminish, particularly as Asia's domestic consumer markets are growing rapidly.

4. While letters of credit have largely been eclipsed by open account trading as a means of financing trade out of Asia, the global financial crisis did expose some counterparty issues which are now being addressed through new trade settlement mechanisms.

5. Sustainability is a particularly high priority for Consumer Markets organisations, as evidenced by the relatively high proportion that have adopted a sustainability reporting mechanism or strategy. It is a now a principal driver for greater visibility across the supply chain.

6. As Consumer organisations look to source from a greater number of countries, and interact with a growing number of Customs authorities and regulations, we see more savings opportunities and compliance risks that need to be managed. The growth or change of scope of sourcing activity in certain markets could alter tax exposures, especially where there is more value being added through product development and testing at the source.

7. Many organisations have invested significantly in technology to enable their procurement process and lighten their inventory burden. While some have reached the appropriate balance on cost, return and risks, others are still facing the challenge of aligning their technology investment with the overall procurement strategy.

Asia's sourcing locations: What has changed and where do you look next?

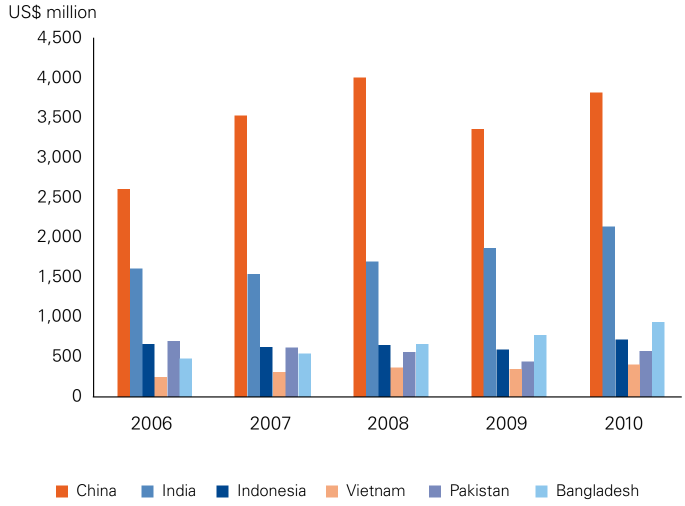
Asia Pacific is the most important region in the world for the sourcing of a range of consumer products — from apparel and textiles to hard goods such as furniture and consumer electronics. Within the region, China continues to dominate the sourcing map. Taken as a whole, it is a formidable exporting powerhouse. Figures from the US Journal of Commerce show that in the first quarter of 2011, goods from China accounted for 45 percent of total US imports of container cargo, a 1 percent drop year-on-year. Paling in comparison, the second-largest source country was South Korea, with a more modest 4 percent share.[1]

China is itself a collection of different sourcing markets, with differing levels of infrastructure development and well-established clusters in coastal provinces such as Zhejiang, Fujian and Guangdong. Although it may no longer be the center of gravity for low-wage production that it was a decade ago, the opening up of China's interior provinces has created new potential sourcing locations, with many factory owners relocating westward. However, the increased affluence of China's interior has also placed further strain on the supply of labor and other key production inputs. In the first quarter of 2011, high commodity prices and stronger demand for imported goods pushed China into a trade deficit for the first time in seven years.[2]

As this report details, apparel manufacturing is widely spread across the region, with lower-cost locations including Vietnam, Cambodia, Indonesia, India, Pakistan and Bangladesh all offering viable opportunities and specialization in certain product types. Many of these locations have been significant apparel or textile producers for decades, but figures 1 and 2 show that none have been able to match the scale of export production from China. In apparel, footwear and leather categories, China's output dipped in 2009 as orders from Western markets shrank. Manufacturers at the lower end of the value chain, particularly those with poorly managed working capital, were the hardest hit with many forced to close. However, the data for 2010, where available, suggests that China's production has rebounded strongly. Exports of footwear, for example, jumped by 29 percent year on year, while exports of leather goods rebounded by 38 percent.

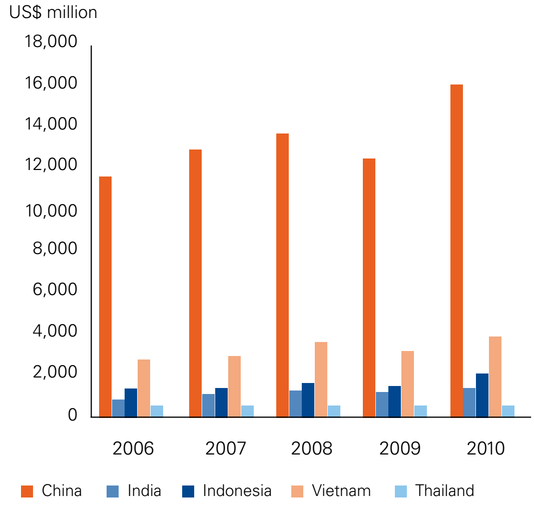
1 "Shipping Figures Show U.S. Apparel, Footwear Imports Shifting From China to SE Asia, Central America," PR Newswire, 9 May 2011
2 "China Posts First Quarterly Trade Deficit in Seven Years," Asia Wall Street Journal, 11 April 2011

Fig. 1 Exports of cotton shirts and blouses



Source: UN Comtrade statistics[3]
Bangladesh 2008-10 and Vietnam 2010 and India 2010 based on KPMG estimates

Fig. 2 Exports of footwear (leather or upper textiles)



Source: UN Comtrade statistics
India 2010 based on KPMG estimates

Among the main exporters in the region, only Indonesia and Bangladesh could match these dramatic growth rates. Indonesia's exports of footwear rose 42 percent in 2010, according to UN Comtrade data. Buoyed by favourable duty rates with the EU, Bangladesh recorded that its exports of textiles had grown by 43 percent to US$18.3 billion in the fiscal year ending July 2011.[4]

Countries such as Bangladesh and Vietnam are now producing on a more dramatic scale as their infrastructure develops. Vietnam more than doubled its exports of footwear between 2006 and 2009. India, long known as a center for fancy hand-stitched textiles, is increasing its exports of hard goods, including home furnishings.

Overall, the data for hard goods suggests far less mobility of production and, in most categories, China has an even more dominant position. Hard goods are typically less labor intensive, making wages a less critical consideration. Conversely, the complexity of production processes necessitates more mature supply chains and results in a clustering effect, which can allow supporting service industries to grow.

In our discussions with sourcing executives, China remains the principal source for many manufactured hard goods. As one executive explained, "China is the only location where you can source anything. In every other country, you can only source some things. China may no longer be the lowest cost sourcing destination, but it remains highly competitive due to the completeness of its supply chains, its ability to produce at scale, and continually improving productivity."

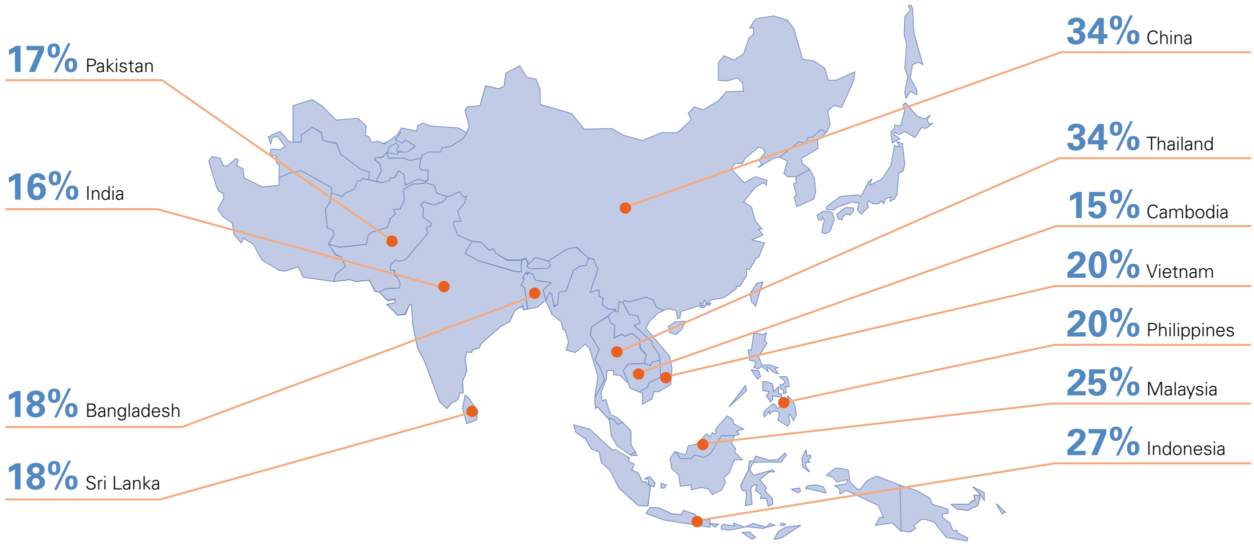
Nevertheless, there are signs of shifts, with new locations appearing as competitive alternatives. The threat of anti-dumping measures and protectionism is forcing companies to assess the extent of their reliance on China. Meanwhile, higher logistics costs are forcing companies to look at closer-to-home locations (for European buyers, Turkey or Poland were both mentioned frequently in our discussions with sourcing executives. In the Americas, Central American countries such as Honduras are emerging for apparel production).

Global retailers and sourcing companies continue to reassess the role that Asian countries are playing in their supply chains. If necessity dictates that production is increasingly scattered across a number of countries, there will be many implications

3 United Nations Commodity Trade Statistics Database, Department of Economic and Social Affairs/ Statistics Division; http://comtrade.un.org/db/
UN Comtrade Data is compiled based on submissions from individual countries. Where countries have not submitted data for a certain year, KPMG estimates are based on secondary sources of information.

4 Bangladesh Garment Manufacturers and Exporters Association; www.bgmea.com.bd

Fig. 3 Capacity to grow
Manufacturing as % of GDP in selected Asian countries



Source: World Bank, KPMG analysis

Fig. 4 Determining factors for sourcing location

Product characteristic	Location characteristic	Implication
Labor intensity of production	Higher labor intensity means wage levels are a more critical factor	Production will seek out lowest-cost areas with abundant workforces. In our discussions with sourcing executives, the most common destinations which can combine scale and lower cost are India, Bangladesh and Indonesia
Complexity of production process, multiple production stages	More complex production means greater likelihood of clustering; automation is more important than labor	In the short and medium term, mobility of production will be lower; potential for consolidation of fragmented producers
Physical characteristics (value density, weight, special storage requirements)	For products with certain characteristics, the importance of logistics and infrastructure is higher	Investment in supply chain infrastructure can alter landscape, but only over a 5–10 year time frame. Bangladesh and Vietnam are both countries that are investing in new infrastructure
Importance of speed to market (e.g. fast fashion versus essential wear)	Proximity to end market and capacity in infrastructure to ensure delivery is more critical factor	Higher transport costs and demands for rapid delivery are leading to some movement from Asia to locations such as Turkey and Eastern Europe
Susceptibility of product to changes in tariffs or anti-dumping legislation	Changes can necessitate very sudden switch in sourcing location to meet demand	Most organizations seem disinclined to alter long-term sourcing strategies on this basis. However when tariffs or protectionist measures arise they can can create opportunities for other countries to establish themselves.

in terms of business structuring, working capital management, risk management, tax, and business process engineering, which we address later in this paper.

Equally, many sourcing executives are confronting the unavoidable reality that China will remain their largest sourcing market. They attribute this to its scale and high levels of productivity, relative to other locations with lower wage and operating costs. Executives therefore need to understand the implications of this, identifying where further productivity gains can be achieved to counter higher costs and a strengthening currency – and also how they will be affected by the growth of China's domestic consumer markets.

Labor dynamics: Supply and cost

Why have certain locations taken off as sourcing locations, and why, in other cases, does production relocate so slowly, even when factor costs are eroding competitiveness? While wage levels are an easy point of comparison when assessing different sourcing locations, the age and quality of a country's workforce is key to understanding its future potential.

China has a rapidly aging population – the size of its 18-30 year-old population is stabilizing and will shortly fall as a result of the country's one-child policy. This has resulted in sudden and serious shortages of the labor needed to meet current and future production requirements. This affecting both manufacturing and services, and in both the coastal and interior provinces, thus providing the workforce with the leverage to demand higher wages.

While the average Chinese citizen is 34 years old, the average Bangladeshi, Cambodian, Pakistani, and Filipino, by contrast, is almost 10 years younger (Table 1). The demographics of these three countries look much like the demographics of China in the early 1990s, at the time its export manufacturing sector started to boom on the back of cheap labor.

Table 1: Median age

	Years
Pakistan	21
Cambodia	22
Philippines	23
Bangladesh	25
India	25
Malaysia	26
Indonesia	28
Vietnam	29
Sri Lanka	31
Thailand	33
China	34

However, wage inflation is not a problem unique to China. In India, for instance, official data shows that average wages at cotton mills have been rising around 10 percent per annum over the past few years.[5] Producers in Bangladesh also face pressure to increase wages as food prices and other basic living costs soar. In 2010, Bangladesh's minimum wage levels doubled year-on-year, however further protests over wages caused disruption to a major manufacturing zone in June 2011.[6]

The global buyers interviewed in this report largely agreed that it will be impossible to avoid the challenge of rising wages entirely, wherever you are in the region. However, it is relative increases that matter when measuring a country's competitiveness in labor-intensive sectors. That being the case, there will still be good reason to invest more in younger and cheaper countries, such as Bangladesh, Pakistan, and the Philippines.

Complexity of production

The reality is that for apparel and many hard goods, the importance of wages as an input cost is declining. Efficiency can be obtained through Lean approaches[7] that minimize or rationalize the human inputs into the production process. As one executive explained to us, "In a business where low wages are a preoccupation, it is easy for the management to look to a human solution when things go wrong. If, for example, the cost of a garment worker's time is lower than the cost of replacing a needle on the production line, the manager may have little incentive to introduce more systematic processes and controls. Yet it is only when this cost equation is challenged that defect rates (for example broken stitches) are reduced and productivity significantly enhanced."

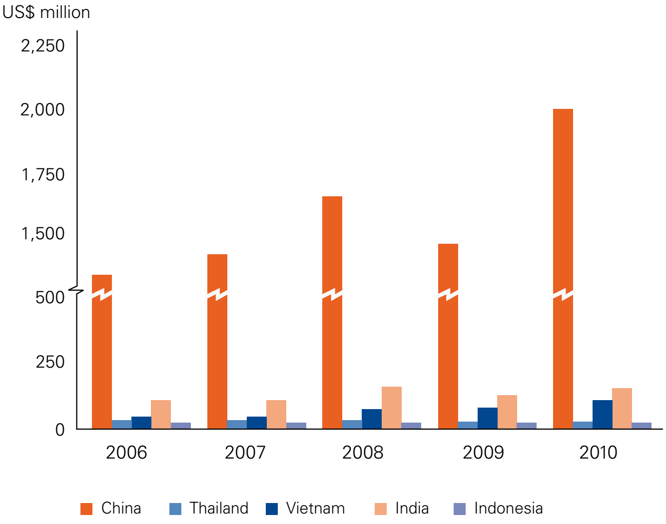
Chinese manufacturers may be losing out on the cost equation, but their decades of experience continue to give them an advantage. Many have previous experience of mobilizing and relocating production in response to changing economic conditions. In the electronics sector, Taiwanese original equipment manufacturers (OEMs) were quick to shift production to China in the 1990s. The same was true of Korea, Japan, and other electronics producing countries. China now enjoys enormous economies of scale, and one of the advantages of establishing electronics companies in China is that a factory can source many of its goods from the same country, province, or even district.

This does not prevent countries from producing single component parts for export to China, as is the case with Thailand, but it does make it difficult to capture large parts of the electronics production value chain. The upshot is that China has few serious competitors, particularly in the assembly of electronic and hard goods.

Also instrumental to the decision of manufacturers to shift their regional production patterns in the region is the proliferation of free trade agreements (FTAs). These have made raw material sourcing in certain locations more cost-effective, due to reduced duty rates on raw materials and finished products. The ASEAN-China FTA, for example, has created alternative locations in several Southeast Asian countries for multinational companies to move their production facilities and gain two-way access to the China market for both raw materials and finished goods.

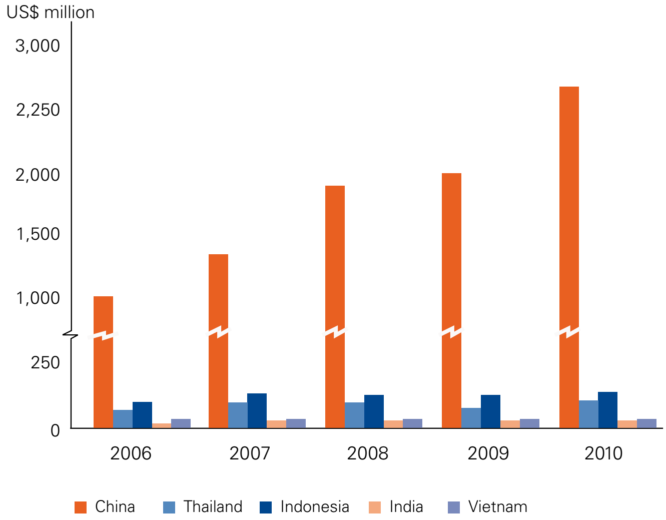
5 CEIC Data
6 "Bangladesh Garment Workers Awarded Higher Pay," New York Times, 28 July 2010; Bangladesh textile factories shut over pay dispute," Reuters, 22 June 2011
7 Lean is defined as a customer-centric approach to maximizing value and eliminating wasteful activity in a manufacturing process or service.

Fig. 5: Exports of leather goods (bags, accessories, leather apparel)



Source: UN Comtrade statistics
Vietnam and India 2010 based on KPMG estimates

Fig. 6: Exports of glass home ware products

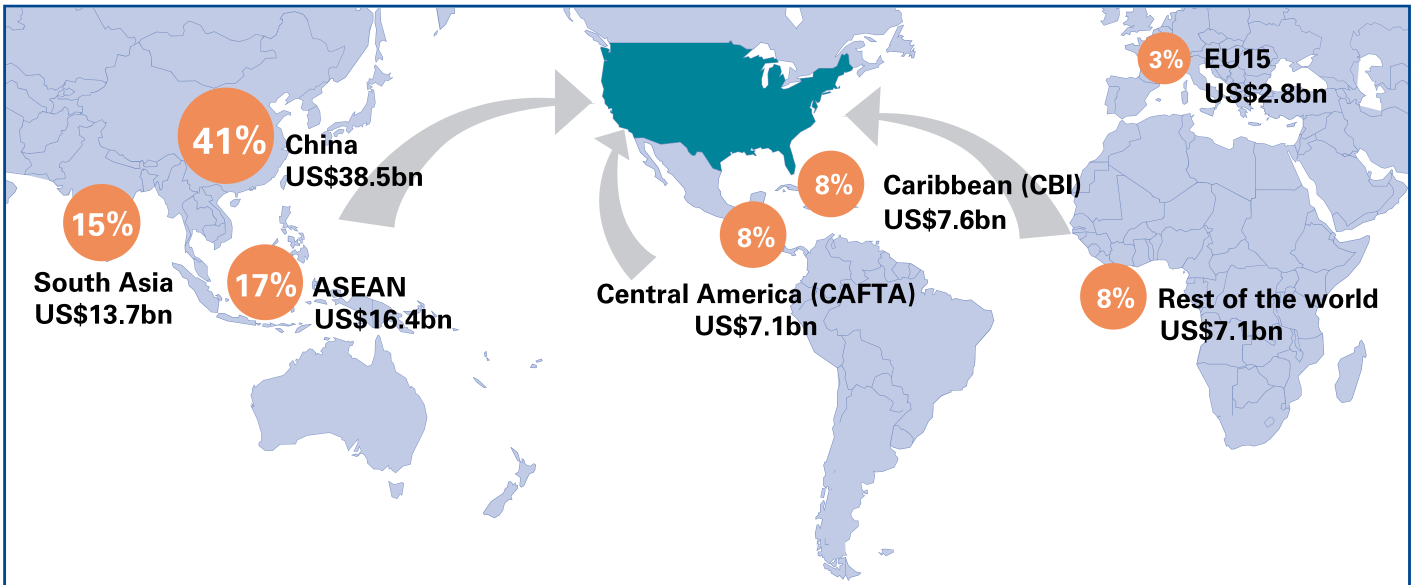


Source: UN Comtrade statistics

Logistics: Cost and speed

With sourcing executives proclaiming "the end of cheap" production and preoccupied by the demands for ethical and high-quality production, the next source of competitive advantage may come through efficiency in logistics. Logistics factors not only help to determine the choice of sourcing location, but are also becoming a driver behind sourcing models. As one executive explained, "Whether it is the Suez Canal or the ports of Eastern China, it is critical for a sourcing executive to understand where the crossroads of global logistics are, where they will be in the future, and then map a strategy around them."

Fig. 7: 2010 total textile and apparel imports to the US



The US imported US$ 93.3 billion of textiles and apparel in 2010, a rise from US$ 81.0 billion in 2009, according to statistics from the Department of Commerce. China's share of those imports actually rose from 39 percent to 41 percent in 2010, while Asia as a whole accounted for more than two-thirds of all imports. India's exports to the US rose from US$ 4.6 billion to US$ 5.4 billion.

Source: US Department of Commerce – Office of Textiles and Apparel (OTEXA)

Heavy consumer durables and other hard goods tend to incur higher transportation costs and require more specialized processes, so production of such goods is naturally less likely to be relocated to the lowest-cost center. Western European countries such as Italy still produce washing machines. It makes sense to keep production of some heavier goods close to home, or move to near locations such as Eastern Europe.

Asia has seen some more unusual shifts. For example, in 2008, China's white-goods giant Haier announced plans to develop India into a hub for exports of refrigerators to Africa, the Middle East, and some other parts of Asia. India has still been able to grow its exports of many heavy durables due to its position astride the huge regional markets of Europe and East Asia.

China has few rivals when it comes to infrastructure. It boasts nine of the world's top 50 container ports, including Hong Kong. Korea and Malaysia each have two container ports in the top 50, while more direct competitors, such as India, Vietnam, and the Philippines, each boast a single port. Access to logistics and concerns relating to lengthening supply chains may deter some factories from moving further into China's hinterland, but investment in high-speed road and rail networks means new locations are becoming accessible.

The development of rail links between China, Central Asia and the Middle East is already accelerating, and might logically extend through to Europe," explains Ben Simpfendorfer, Managing Director of Silk Road Associates and author of *The New Silk Road*. "The fact rail transport is faster than sea would help to maintain China's competiveness against low-cost Eastern European producers, even as the RMB appreciates and other production costs rise. Rail transport is not a substitute for sea, but it could act as a hedge against the risk of supply chain disruption at critical maritime choke in the Middle East. China's railways have historically prioritized transportation of resources such as coal, but the gradual drift of factories inland, as far as the Western provinces, also makes rail a consideration for China's state planners.

China's influence in global shipping is less significant, but with the physical infrastructure in place there are signs that this may also be starting to change, as detailed in the next section of the report. Chinese shipping companies' growing scale and presence in global markets may continue to hand the country an advantage as, in some other respects, it becomes less competitive over time.

Manufacturers able to ship by air-freight are more able to move factories away from ports. Light electronics have a higher value density, and if the air infrastructure is in place, it can allow production to move to new inland regions. Hon Hai and its susidiary Foxconn, a maker of products for Apple, Nokia, and Hewlett Packard, is doing exactly that, and is in the process of moving an estimated 200,000 employees to inland cities in China.[8]

For most sourcing operations, shipping is a critical factor in the sourcing model, and many executives have explained that they are looking at lower-cost and slower options for shipping, which in the long term may improve prospects for closer-to-market sourcing. However, some sourcing executives believed this may be a false dawn for producers in locations such as Eastern Europe and the Middle East. As one executive explained, "Ultimately, the scale offered by markets like China and potentially India will assure them a continued role. Companies are looking at overland routes for rail transport through Central Asia so we could soon see 15-day delivery times for shipments from Shanghai to Turkey or Central Europe."

Completeness of supply chain and speed to market

While many executives believed the completeness of China's supply chains give it an advantage as a sourcing destination, the relative fragmentation among Southeast Asian economies has not prevented many of them from also becoming significant exporters, particularly in apparel and footwear categories (see fig. 7).

Michael Blakeley, a Principal Associate of Nathan Associates Inc. and the Director of the VALUE Project, a US-funded initiative to promote economic integration across Southeast Asia, believes the move by the Association of Southeast Asian Nations (ASEAN) toward creating a single ASEAN Economic Community by 2015 could help further improve the competitiveness of producers in this region as barriers to trade fall and supply chains that extend across borders become more manageable.

"If you look at textile and apparel exports to the United States, ASEAN is faring well relative to other regions such as the Middle East or Central and South America," Blakeley explained. "Many of those have free trade agreements or preferential trade arrangements that provide duty-free treatment of apparel, yet their exports are far less than those from Southeast Asia. Southeast Asian producers are therefore in a good position, but they do realize that their supply chains are rather disaggregated. In textiles, you have strong capabilities in cutting and dying in countries such as Malaysia, while countries such as Vietnam or Indonesia are more specialized in apparel manufacturing largely due to their relatively lower costs. The industry players realize that they have to overcome these challenges as speed to market (and minimizing mark downs) is becoming more critical," he added.

The VALUE Project has established the Source ASEAN Full Service Alliance (SAFSA) to help manufacturers across ASEAN collaborate. One element of this is the creation of virtual vertical factories (VVFs), which allow the manufacturer to provide a greater number of the pre-production services for a garment, thereby lowering costs to the buyer and shortening lead times of delivery. So far, more than 20 factories have signed up, and these have signed memoranda of understanding (MOUs) with a number of leading western and Japanese apparel companies.

"ASEAN is looking at what it must do to compete with all regions of the world, as companies explore new regions for sourcing," Blakeley explained. "While China's Five-Year Plan has indicated a shift in emphasis towards infrastructure and higher technology industries, ASEAN governments still see sectors such as textiles as strong contributors to economic development and poverty alleviation. With greater regional integration, Southeast Asian producers can benefit from more maturity in key supporting services such as sampling, sourcing of inputs and logistics."

8 "Foxconn to move China jobs inland," Financial Times, 3 March 2011

Li & Fung Limited

Dr William Fung Kwok Lun, Executive Deputy Chairman, Li & Fung Limited

Dr William Fung took over as Executive Deputy Chairman of the Hong Kong-based multinational Li & Fung Limited in May 2011. Next year will also see Fung take over the chairmanship from his brother, Dr Victor Fung, by the next Annual General Meeting.

Fung is keen to play down the changes in leadership, which, he explained, are less important than reacting to elemental shifts in the market. "We work in three year plans," he said. "Our strategy is always based around what's happening in the market. Right now it is going through a momentous change that relates to China and how it impacts the world."

Li & Fung was founded in Guangzhou in 1906 by Victor's and William's grandfather. In just over a century, the company has become one of the largest global supply chains for consumer goods in the world. Today, Li & Fung has 240 offices and distribution centers in over 40 economies, 27,000 employees, and an annual turnover of over US$15 billion.

Flexibility and foresight have been crucial to its survival and phenomenal growth over the years, said Fung. "If you look at our long history, there have been many instances where we could have just disappeared if we didn't keep up with the changes."

One hallmark of Li & Fung's strategy is its ability and willingness to adapt to global trends, using radical company reinvention if necessary. Fung commented that Li & Fung managers, who are nicknamed "Little John Waynes," must be able to lead a team that is "able to change ahead of time. Sometimes they have to change the business fundamentally."

The retreat of China as the world's largest manufacturing center for low-cost goods is one trend that is forcing Li & Fung to reassess business. Fung is certain that the era of cheap production is over, due to a combination of wage rises in China and an increase in both the price of raw materials and energy globally. "First of all, consumers may have to pay more and as a result they will probably consume less," he explained. "This is probably a good thing – there was a period of conspicuous overconsumption over the last thirty years."

Fung believes that it is a mistake, however, to view China as a single market. Critically, Li & Fung are minimizing the impact of rising production costs in China by moving supply chains to cheaper provinces. Fung commented, "Many parts of China are developing at different speeds. We are looking at many sourcing markets, not just one." As such, China's interior provinces are serving as new potential sourcing locations and alternatives to the more developed coastal and Yangtze River delta regions, where labor costs are high. "In China we look for areas where we can still use the same supply chain and try to extend it. Instead of bringing fabric a hundred yards across one factory to the other, we now pick the same fabric and ship it to another province to make it."

Responding to this trend, Li & Fung made a significant investment in the logistical side of the business by acquiring Integrated Distribution Services (IDS) in November 2010. Through IDS, Li & Fung now provides more vertically integrated distribution services, including the three core areas of marketing, logistics, and manufacturing. It does this through a large network across Greater China and Asia that covers over 150 cities and 10,000 outlets, enabling products to flow into Europe and the US from Asia.

Indeed, another element of the company's strategy is diversification away from China altogether. "We always have to search for the next market," explained Fung, adding that potential peripheral sourcing markets now include Vietnam, Cambodia, Indonesia, Bangladesh, India, Pakistan, Sri Lanka, and newly developing countries in Africa and South America. Proximity to the end market is also crucial in an era of faster turnover of commodities – particularly in apparel – and increased shipping costs. Therefore, the north coast of Africa is significant to Li & Fung as a quick response market to Europe, while Central and South America serves the US.

Metro Group Buying

Michael Ciesielski, CEO, Metro Group Buying Hong Kong Ltd

Michael Ciesielski started his career with Metro Group Buying Hong Kong Ltd (MGB) on the retailing side. As he now heads the entire sourcing business, he finds his background gives him a valuable perspective. "I can see how much trouble it causes (on the shop floor) when there is a mistake in the sourcing process — a defect or a labeling error for example. It is absolutely critical that the sourcing operation is an enabler right the way through the supply chain to get the best products to our customers," he said.

MGB HK sources over EUR1 billion of goods a year for its Germany-headquartered parent's 2,400 stores. Headquartered in Hong Kong, MGB has representative or relation offices located in Bangladesh, China (Shanghai), India, Turkey, and Vietnam. Prior to his move to Hong Kong, Ciesielski spent two years heading up the Metro Group's India office in New Delhi.

As a standalone profit center, MGB must prove its value and compete against external competitors. "Our mission is to provide unbeatable products, excellent service and simple processes," Ciesielski said. "We compete against many smaller importers that have specialism in certain products or locations. We have to match them in terms of our product focus and differentiate ourselves by leveraging our scale and making processes as simple as possible for our customers."

Ciesielski explained that MGB sources for over 30 countries, each with its own regulations and documentation procedures. He believes smaller competitors may struggle as costs rise and demands around corporate social responsibility (CSR) intensify. These complexities are necessitating closer relationships with suppliers and constant re-evaluation of the most suitable sourcing locations.

Ciesielski also believes that, as a founding member of the Business Social Compliance Initiative (BSCI) in 2002, MGB can be a real enabler for the adoption of CSR. He sees two sides to the growing need for CSR.

The first is working with suppliers. "We have really upsized our team to conduct evaluations and the responsibilities and expectations on that team are growing all the time," he explained. "The focus is on the product, the customer expects a clean product."

"Developing supplier relations is a natural process now. The BSCI is working to harmonize codes of conduct for ethical supply chains among its hundreds of members. When we first started educating our suppliers about this initiative, we thought some might back away from us or try to raise their prices. That hasn't proved to be the case because they also see the benefit of harmonization. What it has done is give us another lens through which to filter our suppliers, improve concentration, and build sustainable relationships," he said.

In the current economic climate, this is particularly relevant. "Our suppliers in China are concerned by rising labor costs and appreciation of the renminbi, just as we are," Ciesielski continued. "We have been involved in discussions with a number of suppliers who are considering relocating, for example, from China to Vietnam. We have a vested interest in their decisions and will try to offer them advice or assistance."

The second impact of CSR is on MGB's internal efficiency and environmental footprint. "We are looking at what we can do ourselves in terms of energy and resource efficiency," he said. "Our CFO has driven initiatives to reduce our use of paper and energy, but there is more to be done in harnessing technology. We can grow and leverage our scale and this can benefit our environmental footprint as well."

"I think we can easily double the size of our business by bringing the power of our group together," Ciesielski concludes.

The costs of seaborne trade out of Asia

By Tom Leander, editor-in-chief, Asia, Lloyd's List

For global sourcing companies, gauging the cost of seaborne transport of goods to and from Asia can be one of the most daunting variables affecting their business.

To manufacturers, sudden rate hikes can add unforgiving costs to supply chains. Shipowners, in contrast, argue that they operate in an environment in which their costs to operate – from crewing to fuel oil – are too punishing to bear. Moreover, imbalances of supply and demand mean that they must seize a measure of control to ensure their survival.

As in any good drama, each opposing party has some claim to the truth. Yet after a period of historically high prices, the balance of good fortune may be tilting back in favor of customers. For the near term – two years at least – manufacturers that ship goods on Asian trade lanes will enjoy a respite from the cripplingly high rates that existed before the global economic crisis, and that, for the balance of 2010, looked as if they would stage a Lazarus-style comeback.

That revival appears not to have materialized, as a combination of forces will work to hold down rates throughout this year and most likely in 2012. These include the slow pace of global economic recovery, a still heavy supply of boxships in the world's fleet, and – looking farther ahead in time –a fuller entry of Chinese-owned vessels into global trade lanes adding to boxship capacity.

To shippers of consumer goods, this is a better outcome than might have been expected in early 2010, when freight rates shot up in response to the sudden revival of trade. Following the fall of Lehman Brothers in September 2008, the near catastrophic slowdown of global trade through the first quarter of 2009, and the very slow revival thereafter, almost every container line was operating at a loss – effectively subsidizing the transport of shippers' goods through the mere act of operating their businesses.

They kept transport rolling, but only to maintain cash flow. Collectively – although not strictly in collusion – they began putting their ships into layup, removing capacity from the market, and delaying delivery of new vessels until better market prospects made the launching of these new ships financially viable.

At first, the effect of layups was minimal; global trade languished through December of 2009. Owners were convinced that the world was in for a very long trough and kept ships off the high seas. Then came what some in the industry have dubbed the January surprise – a sudden of rush of reordering that went on consistently through the Chinese New Year of 2010 and then continued during the summer. What the world was witnessing was an almost universal restocking after manufacturing inventories whittled down through 2009. Supply chains – with China, as always, at the hub – were virtually depleted. The speed of the recovery not only took shipowners, but also their customers, by surprise.

As evidence of the pace of recovery, seaborne trade by volume rose 13.5 percent in 2010 to over 4 billion tonnes, according to Lloyd's List Intelligence. Of that, 23 percent, or 1.8 billion tonnes, was moving goods to or from China. Over 40 percent of world container port callings now occur in Asia. One surprising fact is that the sturdiness of Asia's growth story sustained itself even during the worst period of the Great Recession. Between 2008 and 2010, the total volumes of twenty-foot equivalent unit (TEU) containers calling at Asian ports continued to rise.

Shipowners' response to the trade revival has been the subject of controversy. Freight rates began to rise quickly. Some customers accused shipowners of keeping ships out of operation to stoke rates even more, most likely as a way of recouping some of the losses they incurred when they operated 'under the water' in 2009. Shippers that sent goods on the transpacific trade lanes were the most vocal. Eventually, groups such as the Transpacific Stabilization Agreement – a group of shipowners that meet regularly to discuss policy on such issues as rates and layups – took measures to improve dialogue with their customers, who complained fervently that the cost of shipping goods had shot up at an unwarranted rate just as their businesses were recovering.

The acrimony eased through the summer of 2010, and has not returned, because beginning in October of last year, freight rates have fallen into a slow decline and have shown no signs of recovery.

Much of this can be pegged to the uncertain nature of the global recovery. The world's biggest trade lane runs between Asia and Europe through the Suez Canal, and activity on it is contingent on the economic health of Europe. The European recovery has been beset by the woes of Greece, Ireland, and Spain, while the slow jobless recovery in the US provides little reason for optimism. It would seem that the period of restocking in the first half of 2010 was a false dawn and that a full recovery has not yet occurred.

For manufacturers with businesses throughout Asia, there is some good news in this. The cost to transport their goods is unlikely to rise quickly, as shipowners have to contend with the double challenge of weaker demand than they hoped for in 2010 and a global container fleet that still has too many ships to account for the number of goods that shippers send on them.

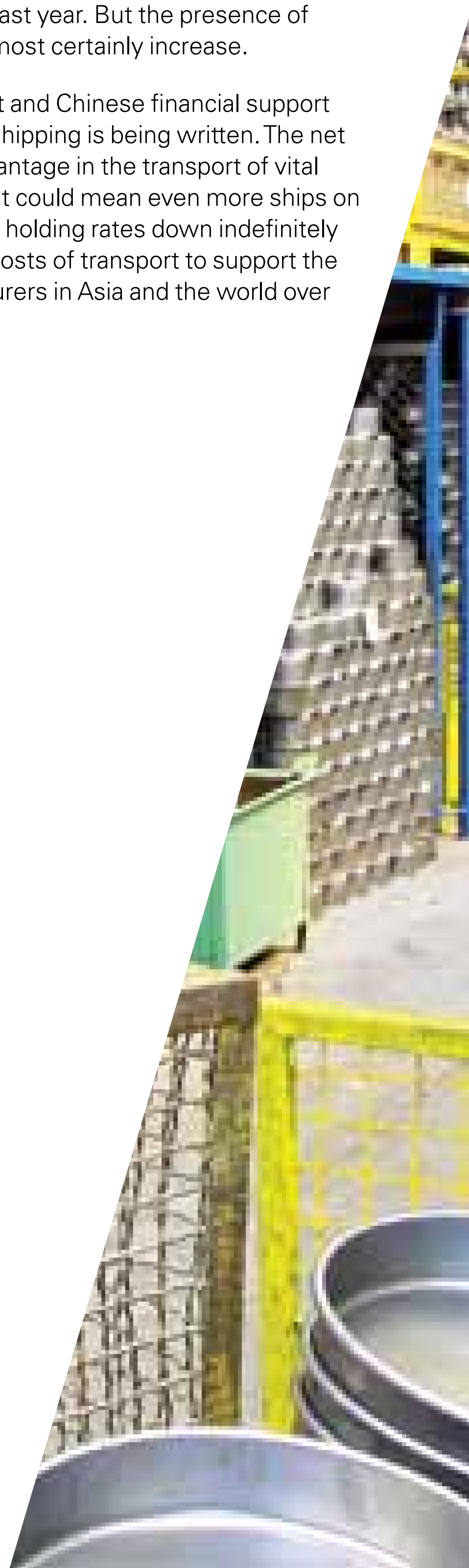
After a long lull in ordering in 2009 and the first half of 2010, all the major container lines began ordering new ships once more. Because of the lifecycle of ships – it takes roughly 18 months to build a big vessel, which then has between 15 and 20 years of active trading life before it is taken off the market and scrapped – owners must order steadily to keep ship supply at an even level with demand. But since no owners know more than any economist about what will happen in the future, there is an element of gambling to the building of any orderbook.

As it stands today, the number of ships in the global container fleet will dwindle as a consequence of the long fallow period of ordering in the wake of the global economic crisis. But this period of shortfall will not take out enough supply to compensate for the ships already in active trading, unless the global recovery makes an unexpected shift into a higher gear. That implies that while rates may climb again in 2012 as ship supply eases, they will stay in an affordable band for manufacturers.

Shipowners, at least, are betting that this is the case. This can be seen from a change in their ordering patterns, which anticipates a world in which freight rates remain at a modest level of growth for several years at least. AP Moller Maersk, owner of the world's biggest container line, announced early in 2011 that it would order a swath of container vessels of immense size – 18,000 TEU – and was followed by several major lines that all ordered ships at 12,000 TEU or above. These ships are destined for the Asia–Europe trades. The rationale for building them is simple; large ships create economies of scale, allowing owners in a low-rate environment a fighting chance for solid profits. Of course, to make good money, these huge vessels must be mostly filled all the time. But, as stated, the shipowning business has always had an element of an intelligent gamble.

The wild card in this game is China. As Lloyd's List Intelligence has pointed out, only a fifth of calls by Chinese-owned vessels took place outside of Asia in 2010. Taking Hong Kong-owned vessels out of the picture, only a tenth of the calls by mainland China-owned vessels took place outside of Asia last year. But the presence of Chinese-owned vessels in the global fleet will almost certainly increase.

As more Chinese built ships enter the global fleet and Chinese financial support of shipping accelerates, a new chapter in global shipping is being written. The net effect will be that China retains an economic advantage in the transport of vital goods to support its continued development. That could mean even more ships on the crowded oceans for owners to contend with, holding rates down indefinitely – a state of affairs that would sustain affordable costs of transport to support the seaborne legs of global supply chains. Manufacturers in Asia and the world over could get used to that.



Shop Direct Group

Lars Thorsen, Group Sourcing Director, Shop Direct Group

"Last year [2010] was the most interesting of my 18 years in the sourcing business," said Lars Thorsen, Group Sourcing Director for Shop Direct Group, the UK-based online and catalogue retail business. "Shipping capacity tightened. Suppliers started prioritising or even turning down orders. Input costs all went in the wrong direction. Shipping out of China at low cost, particularly for bulky items, suddenly became very challenging," he said.

The tightening of supply implies that prices sometimes move in the middle of the season and the buying-in margin is quickly eroded. In response, Mr. Thorsen has taken the opportunity to implement a much tighter critical-path management system and is looking at more innovative strategies for hedging against volatile prices.

The company has also implemented a new global sourcing strategy, with supplier selection based on a one-in, one-out principle. "We have cut our supplier base almost by half and are focusing on the lowest 20 percent of the supplier base in terms of performance," he explained. "There was too much inefficiency in working with some smaller or less reliable factories, some of which may only provide one or two orders per year."

The new strategy is focused on proactively developing global sourcing opportunities to protect margins and capacity and take advantage of emerging markets, mitigating risk by striking a balance between key geographies, and building an efficient foundation of suppliers, which can be built upon to provide future value to the business.

With that in mind, for those suppliers who remain on the list, there is now a more consistent engagement and disengagement process. "We now engage our top-tier suppliers on an ongoing basis at a senior management level. We invite their management to our UK headquarters and we make sure they see us as supporters who will stand by them if there are any difficulties. Then there are other key suppliers on which we may be less reliant but which we want to see develop and grow," Thorsen said.

He also believes that "an orchestrated turnover" of between 10–20 percent of the supplier base each year is healthy.

The new selection strategy has required some change of mindsets within Thorsen's buying teams. "From the management point of view, I need to apply a bit of skepticism in supervising my teams," he explained. "Buyers cannot just introduce a new supplier in the middle of a season, however attractive they may appear to be. The teams need clear direction on shape, size, and type of supplier. To uphold the integrity of our selection process, I also make sure the factories are clear about our selection metrics and realize that the individual buyer they are dealing with has limited decision making power."

One area where close partnering can help improve efficiency is payments. "With the right relationships you can handle payments better and avoid costly letters of credit," he explained. "In some of our newer sourcing locations such as India and Vietnam, the payments process is still more challenging. Developing the banking infrastructure will be a key to the future development of these markets."

Thorsen has already seen some marked shifts in production, with more apparel being sourced in Turkey and furniture in Eastern European countries. However, he also suspects that China will come through the current situation even stronger in some respects. "We are still very reliant on China, especially for hard goods, because you can get phenomenal productivity," he explained. "We may see some consolidation in China and, two or three years down the line, I wouldn't be surprised if we see Chinese producers performing even more strongly."

Looking elsewhere in the region, Thorsen sees an abundance of sourcing opportunities and believes these will be driven by a combination of labor and infrastructural factors. "There are huge investments in infrastructure occurring across Asia and these will really change the picture over a three-to-five-year time frame," he predicted. "Cambodia and Bangladesh are both benefiting from the GSP (Generalised System of Preferences with the European Union), which provides additional export incentives. Manufacturers need to move where the labor is, but infrastructure and logistics are variables that determine how quickly things can really change."

VF Group

Veit Geise, VP for International Sourcing and Alfie Germano, Managing Director, VF Group

While China's 12th Five-Year Plan has implications for consumer goods companies, the VF Group has its own five-year growth plan, which it shares with vendors and raw material suppliers. Sourcing for more than 80 North American and European brands, including Wrangler, The North Face, and Nautica, the VF Group has seen its biggest expansion in Europe and Asia Pacific, with some explosive growth in Asian sales over the past four years.

Veit Geise, VP for International Sourcing, explained that collaboration is more important than ever because "the balance of power has swung in favor of suppliers. They have greater leverage and there is less scope now for people to shop around for different suppliers. We shop around less than we used to."

With over 22 years in the sourcing business across three continents, Geise added, "These tough times do force you to re-engineer and that also means developing closer, more collaborative ties with your suppliers."

Another perspective on the VF Group business can be seen through the eyes of Alfie Germano, MD for a number of the brands. Germano explained that they have been able to re-engineer some of their own internal processes across the various brands. "Every brand has its own specific need, but we have been able to develop 'coalitions' where we gather brands with similar characteristics and cluster these product needs to improve our own efficiency," he said.

Where previously there was a great deal of fragmentation across the teams, VF Group has successfully leveraged these coalitions to share knowledge, manage risks, and reduce the administrative burden. Geise is quick to point out that you also need to balance risk with opportunity, so even with comprehensive vendor risk matrices in place, there needs to be flexibility in the process to get the job done.

VF Group has 25 of its own factories focused primarily on denim and imagewear. Of these, 23 are located in Mexico. However, Asia is also critical and Geise does not see that changing. "As products require more needlework or detail, Asian companies are able to provide those extra value-adds and remain competitive," he explained.

Coming from a textiles family, Germano does believe that China has lost some of its market share. With inflation hitting raw materials, components and labor costs, VF Group has already moved some production to other Asian markets such as Bangladesh. This is a country where Germano has seen a huge build out of supporting infrastructure for the textiles industry.

On more technical products, however, China is still competitive. "Chinese manufacturers are buying up the latest equipment in order to automate and stay competitive," he said, adding that, "Chinese manufacturers are looking to open new factories elsewhere across Asia."

Over the longer term, Germano doesn't see China relinquishing its significant position, due to its strong infrastructure. "The Chinese vendors we are working with have an amazing ability to reinvent themselves and the speed element in China is not matched in many other locations," he explained.

Geise conceded that if the world is to effectively sustain resources, then a correction is needed, as current price levels are simply too low. "We need a fair deal for everyone through the value chain, down to the farmers," he said. "We need a new spirit and we need to move faster towards these more sustainable models."

Another significant challenge is the ever increasing product safety costs, with the business of testing now a major industry in its own right. "These costs need to be absorbed somewhere along the supply chain," he remarked.

Germano added that VF Group has not only set up its own labs to mitigate costs but also initiated its own self-auditing processes to look at setting up those all important industry standards in the future.

Geise added that there is an air of confidence in the VF Group offices and sustainability gives them the least of their worries. Their decades of expertise in both manufacturing and engineering is critical in these times of change.

KPMG viewpoints:

Working capital and trade finance trends

From the need to work more collaboratively with suppliers to the need to respond to the growth of Asia's own consumer markets, many of the trends highlighted in this paper have implications for the way in which organizations finance their supply chains across the region and manage transactions. From open account trading and cash pooling to settlement in different currencies, this section outlines some of the trends in more detail.

Supply chain financial management

The growth of international trade and the related complexity of supply chain management have driven many changes in the way the supply chain is now financed. Traditional trade finance instruments, such as letters of credit (LCs), are no longer the staple of international trade. Rather, businesses have sought to shift to far simpler forms of open account settlement through automated global payments platforms.

Developments in technology and automation have also driven greater integration in the way that working capital, transaction processing, cash management, international payments, and supplier risk are managed. Consequently, this holistic approach to the financial supply chain has driven further developments in how the supply chain itself is managed. This creates opportunities to drive down costs, improve liquidity, and reduce risks.

The switch to open account

According to SWIFT,[9] open account trading now accounts for around 80 percent of all international trades. It represents nearly all of the growth in supply chain finance over the past decade.[10]

For the purpose of managing the ever-growing international trading volume and the varying risks, LCs are both cumbersome and costly. Traditional LCs add multiple administrative workloads to corporates in dealing with an extensive amount of trade documentation to meet the procedural requirements, and as a result the physical supply chain always flows faster than the financial supply chain.

9 Society for Worldwide Interbank Financial Telecommunication
10 gtnews: Open Account Trading: a Question of "Adapt or Die"?

The shift to open-account models fits with the broader priority of many sourcing businesses that are looking to develop more sustainable strategies and trusted relationships with their supply chain partners. It has been facilitated by the availability of more cost-effective solutions from banks, such as invoice discounting or factoring. Open account settlement enables the buyer to obtain credit from suppliers without the need to utilize its own banking facility. The benefits are also felt in terms of closer alignment to the physical supply chain (which provides visibility and transparency for counterparties), efficiency of end-to-end processing of transactions, increased borrowing capacity, and reduced days outstanding.

Implementation challenges

On implementation, open account has presented some challenges. "When the financial crisis hit, finance executives took a closer look at their risk management and recognised that open account settlement exposed them to a number of risks that had previously been mitigated using letters of credit," explained John Bugeja, RBS' Global Head of Trade Products. "We are now seeing the build out of more comprehensive infrastructure to support these transactions."

At the operational, technology, and risk management levels, executives need to address the following important and inter-related concerns:

- Can I have direct visibility of the whole supply chain? For example, can liquidity instruments such as cross-border pooling help obtain a centralized cash visibility, free up cash-flow tied in working capital, and improve overall value chain management performance?

- Do I have the technology to provide the information required? One of the key inhibitors to managing supply chain successfully is the inefficient use of technology to support key information needs.

- Do I have the capability to deal with risk management issues by interpreting and taking actions on this information? For example, with open account approaches, what is the optimal insurance plan to manage counterparty risk, and how should businesses consider FX regulatory and market risk implications when designing and executing a supply chain finance solution.

One developmental area, and an example of the kinds of new platforms being adopted by larger organizations, is the Trade Services Utility (TSU). A SWIFT initiative, the TSU was launched in 2007 and provided a framework for broader bank participation in open account trade. It was a starting point for banks to agree on a data format and standardization that permits automated data matching. The TSU allows buyer and seller data regarding a particular order to be matched at the purchase order stage, so both parties have clarity regarding the order content (goods specification, price, and terms). At the shipment stage, the invoice data can be easily matched to the agreed purchase order data.

A new trade finance instrument to manage risk

The TSU proved to be a vehicle for enhanced efficiency in supply chain management, but it did not mitigate credit risk or provide access to finance. The TSU's second release in 2009 featured the Bank Payment Obligation (BPO). The BPO represents an irrevocable obligation by a buyer's bank to pay a specified amount to a seller's (beneficiary) bank when there is a data match. The BPO mitigates risk between buyer and seller by incorporating an irrevocable, conditional bank undertaking in a transaction. With regard to risk management, payment risk is mitigated with a BPO if shipping data matches the baseline (purchase order) data. For this reason, the BPO may be considered the dematerialized equivalent of a traditional LC in an open account environment.

"For companies that want to do business on an open account basis, the BPO provides an extra level of protection that was formerly not available," explained

Bugeja. "The TSU and BPO will enable banks, as the custodians of these information flows, to offer a variety of value added services and alternative forms of financing, including pre-shipment and post-shipment, earlier in the transaction lifecycle."

The benefits include:

Improved working capital management: The TSU captures data elements specific to the physical and financial supply chain, and therefore a more comprehensive and transparent picture.

Pre-shipment financing: Data matching through the TSU at the purchase order stage mitigates performance risk, while the BPO provides a degree of certainty regarding payment once goods are actually shipped. This enables a seller's bank to adopt a much more positive stance with regard to the provision of pre-shipment financing for the production and shipment of goods.

Vendor performance management: Electronic matching creates an unprecedented level of transaction accuracy. Discrepancies can be identified and corrected at an earlier stage, while supplier fraud can be averted.

Proactive management of foreign exchange risks: Better monitoring of delivery and payment deadlines allows for more proactive management of exchange rate risk.

Payment reconciliation: Standardization of message formats facilitates the reconciliation of payments.

Post-shipment financing: Upon a successful match of shipment and purchase order data, finance can be provided under the BPO by the seller's bank against the irrevocable undertaking of the BPO-issuing bank. Post-shipment finance on this basis is 'without recourse' to the seller, meaning it does not tie up the seller's working capital facilities with its bank.

There have been some challenges affecting the adoption of the TSU and the BPO, including a lack of industry rules and standards beyond those in SWIFT's TSU Rule Book.

Adoption is still far from widespread and in the absence of a universal regulatory and accounting opinion on the treatment of BPO, some banks are drafting agreements with other banks on which rules will apply, resulting in multiple disparate legal agreements that threaten to complicate and delay adoption. Nevertheless, Bugeja does see this changing. "We expect a broader adoption of the TSU and BPO in the next 12 to 16 months, partly because SWIFT is recognised as a trusted and respected provider to banks worldwide," he predicted. "Once companies begin to understand how the BPO provides a more secure alternative for open account trade, establish buyer credit and reduce supplier fraud, and how it can streamline transaction processes, there should be greater uptake."

Managing liquidity across borders

For companies with extensive sourcing operations across the region, managing cash effectively has always been a challenge. Countries such as China, India, Vietnam, and Malaysia all have regulations governing transfers of cash, while countries such as Korea and Thailand are more lightly regulated. Benefitting from their relatively open and developed financial markets, Singapore and Hong Kong have long been popular as regional hubs for cash concentration.

This study highlights how dependent many companies are upon China, but also how many organizations are exploring new alternative locations, both around Asia and elsewhere in the world. Involving more countries in a supply chain is resulting in a need to deal with multiple currencies, thereby increasing the challenges of cross-border cash management, particularly where foreign exchange regulations exist. Companies must also manage high currency volatility, in some cases with limited opportunities to hedge their positions.

After the recent global financial turmoil, some Asian countries, including China, Taiwan, Korea, and India, have imposed stricter currency controls to curb speculative money, making the already challenging task of exchange rate management daunting. Another major consequence of this is that international companies find that they are unable to repatriate cash, or to pool cash among subsidiaries located in different countries, resulting in 'trapped' cash that cannot be used effectively across the organization.

The role of a regional treasury hub

Many companies now rely on a treasury center to manage their regional liquidity, so as to benefit from greater economies of scale. With highly developed and liberalized financial markets, Hong Kong and Singapore have historically been the most attractive regional treasury locations. Some of the key factors companies consider in determining where to set up regional treasury centers include bank transaction fees, prices for foreign incoming and outgoing payments, withholding and corporate tax, reporting requirements, and the credit rating and currency environment. These locations may also offer more advanced liquidity management tools and banking products including multi-bank cash concentration, physical/notional cash pooling, cash reporting, and investment sweeps.

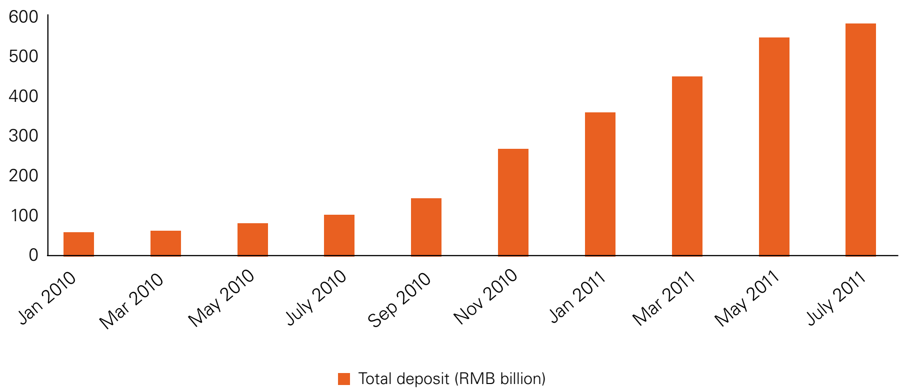
Among those tools, regional cash pooling is the most widely adopted product by companies with regional activities. For regulated countries, companies always concentrate cash into onshore pool header accounts as much as possible while the cash sitting in the free market will be swept into the account in the regional treasury center in a timely manner. In their efforts to enhance their liquidity situation, executives should also consider how changes and new technologies can help in improving their overall visibility over cash.

Possible implications of RMB internationalization

The internationalization of China's currency, the renminbi or RMB, is developing faster than many had expected. Since 2009, the Chinese government has identified the internationalization of the RMB as a main policy goal. Under the so-called pilot program, foreign importers and exporters are allowed to use the RMB as a settlement currency in their trade with China. This program's coverage was further expanded in 2010 and is currently open to all overseas countries and domestically to cover 20 provinces/municipalities (Shanghai, Guangdong, Beijing, Tianjin, Chongqing, Zhejiang, Guangxi, Yunan, Inner Mongolia, Sichuan, Jiangsu, Shangdong, Liaoning, Fujian, Hubei, Heilongjiang, Jilin, Hainan, Xinjiang and Tibet). This has dramatically increased the amount of trade with China that is being settled in RMB.

The Chinese government approved Hong Kong as the first key offshore RMB financial center, and accordingly, RMB deposits in Hong Kong have surged since 2010. If Hong Kong is any indication, these reforms seem set to greatly expand the RMB's international role. Singapore looks set to be approved as the second key offshore RMB settlement center in the near future. As a major commodities trading partner with China and a regional treasury center for many multinationals, Singapore will provide an alternative to Hong Kong as an RMB settlement center.

Fig. 8: Total RMB deposits In Hong Kong



Source: Hong Kong Monetary Authority

Policy implications and challenges

The ongoing internationalization of the RMB is bringing enormous business opportunities and benefits to both Chinese domestic companies and foreign trading firms. These include:

- reduced foreign exchange costs
- simpler processes and shorter turnaround times - RMB vs foreign currency
- strengthened relationship with buyers and sellers
- increased pricing transparency in supply chain.

However, there are still many policy challenges to the further development of cross–border RMB use. The major impediments include:

- The continued existence of various restrictions on funds repatriation
- Limited investment options (mainly available in Hong Kong)
- Relatively high operational costs (for example, expensive NDA hedging and complicated Nostro account setup process).

Overall, the incentive for using the RMB as a settlement currency is very attractive to Chinese importers. However, it remains unclear as to whether overseas traders would readily accept the RMB as a new invoicing currency, due to the limitations listed above. International traders may still prefer to settle in US dollars or switch to a source from other countries, but if they see China continuing to be their primary market for both sourcing and sales, that approach may eventually change.

In the short term, economies with close geographical or strategic ties to China, such as ASEAN countries, are expected to see the fastest growth of RMB trade settlement. Over time, RMB use will be expanded globally if China's trade and investment ties with other parts of the world continue to deepen.

Amer Sports Sourcing

Michel Joulot, VP Sourcing, Amer Sports Sourcing

From tennis racquets and golf clubs to snowboards and bike wheels, Amer Sports sources products that require specialized manufacturing processes and high levels of innovation in materials and design. With internationally recognized brands, including Salomon, Wilson, Atomic, Arc'teryx, Precor, Suunto, and Mavic, the company's success is founded on extremely longstanding and deep relationships with suppliers.

Originating in Finland, Amer Sports started in 1950 as a diversified trading company. It was only in the 1990s that it turned to sporting goods as its principal focus. Amer Sports Sourcing was established in 2006 to bring together the Asia procurement and back office functions for the various brands it represented under one management structure. Previously, each brand ran its own sourcing operations, with Michel Joulot as part of Salomon's sourcing team.

"The consolidation process gave us many opportunities to share best practices, harness technology and improve our leverage as buyers," Joulot explained. "We have now created a competency that transcends our brands. Much of our sourcing business is now set up by product category, rather than according to the brand."

Hong Kong serves as a regional headquarters for all the supporting functions. Amer Sports has established an FIE (foreign-invested enterprise) entity in China and rep offices or equivalent structures in other supplier locations such as Taiwan, Vietnam, Thailand, and Indonesia. Asia accounts for 50 percent of the company's total sourcing activity.

Describing rising labor and material costs as "the new reality that we all face," Joulot firmly believes that we are witnessing the end of cheap manufacturing, not only in China but across the region. However, he is also sure that China will remain a critical sourcing location for his business. "We expect high-end sports equipment will continue to be produced in China, but at the same time, in order to increase our market agility, we are also looking at sourcing closer to European and North American markets," he remarked.

Amer Sports is starting to see China as an end market as well. While sports footwear brands have built up a huge retail presence over the past decade, Chinese consumers' demand for more specialist equipment is still at a nascent stage. "Looking at new sourcing locations in China is not easy and building quality on a high-end product takes some time since even our lower-end equipment lines are technical products, but China is definitely a place to be since we see this growing as a market as well," he added.

One might imagine that the collective bargaining power created by the consolidated sourcing entity was disconcerting to some of the company's suppliers, but Joulot recalled that most soon saw the benefit of working with one larger partner, which could bring greater volumes and more innovation and support. "The synergies across brands and product categories enable us of course to enforce our bargaining power," he said. "However, the changes did put us in a better position to support our key suppliers by sharing long-term plans and helping them in areas such as CSR, for example, by providing more training and clearer consistent policies and processes. Our suppliers definitely get it; the feedback continues to be very positive."

On the question of trade agreements and the impact of government policies, Joulot feels it is important to be scanning the landscape and identifying areas of opportunity, although these should rarely influence longer-term strategy too heavily. "We have to be prepared for things to get more complex and we have to make sure that our business remains sufficiently versatile so we can adapt to changes, including changes in policies or trade incentives. However, I don't think it is wise to build a long-term vision on that basis," he said.

Joulot said what excites him most about his role is "the opportunity to act cross-brand and build a structure and scale to realize future opportunities. We need to prepare our employee mindset to be ready for the change going on around us. They can all be a part of that change by bringing great ideas and creativity to the table."

William E. Connor & Associates

Jacob Rogens, Regional Managing Director, William E. Connor & Associates

William E. Connor distinguishes itself through its transparent, client-centered sourcing model, which helps clients directly source from manufacturers. It serves and advises more than 60 companies, including Dillards, Marks & Spencer, Body Shop, TJX, William Sonoma, Kenneth Cole, and Marc Jacobs, with sourcing split evenly between apparel, other textiles such as for home furnishings, and hard lines.

Jacob Rojens, the company's Regional Managing Director, finds this challenge particularly rewarding. "Being an integral part of our clients' supply chains and forming long-term solutions is the most positive aspect of my work," he said. "We are linking up with world-class brands and retailers to source directly from factories, creating a solution which benefits everyone."

William Connor I founded his business in post-war Japan, acting as a buying agent for US retailers and sourcing primarily from North Asia. In 1985, his son William E. (Chip) Connor relocated the headquarters from Tokyo to Hong Kong and expanded the networks into Southeast Asia and China. The company remains privately held and now employs 1,600 people across 35 offices globally.

"Our growth strategy has mirrored the needs of our clients. We invest in our clients, providing global, long-term, tailored sourcing solutions that range from product development and design through to world class compliance and QA," Rojens explained. "We provide our clients with complete transparency and visibility. We want to work with clients who value these things."

The company plugs its clients into a vast network of over 6,000 suppliers. In dealing with so many locations and suppliers, Rojens believes it is critical to establish trust so that the client can see there is no conflict of interest. "By doing that, we can be a true advisor

and the client knows we only work for them," he explained. "We can help them consider the best sourcing strategy for their needs and work out how they can engineer things differently. For example: How do they place orders? How can they deal with the factory to allow them to work more efficiently? How much sampling do they need to do?"

One area that can cause inefficiency for manufacturers is the need to comply with numerous standards and regulations governing ethics and product safety. Rojens admitted that he is not seeing much progress in efforts to standardize these compliance requirements, but he welcomes the challenge presented by rising expectations around sustainability. "It's part of the difference for us. We know the exact factory any of our clients' products are being manufactured in, at any time," he explained. "In addition, a third of our workforce deals with quality control. Our people are in factories every day, performing rigorous assessments and social compliance audits."

In terms of potential new sourcing locations, he mentioned western China and southern India, but he added, "There is no magic bullet or new country out there." He believes Indonesia has struggled to get the fabrics it needs and to develop complete supply chains to compete with other countries such as China, while India is becoming a more significant sourcing location for soft lines.

As a privately owned business, William E Connor can chart a steady and measured expansion route. Historically sourcing primarily to the US, the company has increased its business with European retailers and is now partnering with several large Asian clients, including providing private label sourcing for one of the largest department store chains in Korea. It is also investing in technology to improve performance and speed. "We are rolling out a new tablet platform to all Quality Assurance teams so we can handle information more efficiently. In an effort to drive cost in an increasingly inflationary environment, we are aggressively investing in technology," Rojens said.

KPMG viewpoints:

Sustainability and supply chain enhancement

The evidence that sustainability is becoming a core consideration for businesses around the world grows stronger every day. Its importance to product sourcing is a common theme running through the case studies in this report.

Sustainability initiatives are being driven by a range of factors, including changes in the macroeconomic environment, changes in supply chain management, heightened expectations among customers and increasing regulation. Equally significantly, sustainability is itself being viewed as a cause for and a driver of innovation.

A 2010 global KPMG survey[11] showed that sustainability has moved up the corporate agenda over the past three years, with 62 percent of companies now having a sustainability strategy, compared with just over half in 2008. This figure was even higher for Consumer Markets companies, where 80 percent had a sustainability strategy in place.

In Asia Pacific, the focus is moving from compliance, with social and environmental audits, to a more strategic approach influencing supply chain management. In particular, four strategic drivers are beginning to change the way companies approach sustainability:

The changing nature of sustainability commitments requires greater engagement. Consumer Markets companies are enhancing the nature and scope of their sustainability programs and commitments, and the majority of these can only be achieved by engaging and working with supply chain partners. For example, Unilever has committed to halving the environmental footprint of its products by 2020, while doubling revenue. To achieve this, it will review and mitigate impacts across the full life cycle of its products, from raw material sourcing through to product use and disposal. Engagement means moving beyond a policing relationship and an end goal can be true environmental innovation yielding original products and financial savings. In addition, buyers are increasingly asking their

11 Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, June 2011

front line suppliers to take on the responsibility of tracking the actions of their own secondary suppliers. This has the potential to remove a degree of burden and risk from buyers, while having the indirect consequence of "raising the game" on sustainability.

Governments are setting more stringent targets. Although regulation around sustainability issues has not historically been as stringent in the Asia Pacific region as elsewhere, there are some indications that this is beginning to change, particularly with respect to carbon. For example, in December 2009, Premier Wen Jiabao announced China's commitment to reduce greenhouse gas emissions per unit of GDP by 40–45 percent by 2020, compared to 2005 levels. China is currently in the process of developing pilot low carbon cities and regions, with a range of schemes and policies likely to be rolled out in 2013. The carbon intensity of operations can be used to assess how suppliers may be affected.

In addition to increasing regulation, carbon will also become a key part of transport costs. For example, the inclusion of aviation in the EU Emissions Trading Scheme from 2012 onward will likely result in increasing freight costs, depending on how the cargo industry decides to pass on the cost to customers. The EU has also indicated that it may extend the program to cover shipping. The latest round of climate change negotiations in Cancun highlighted that a carbon price for global aviation and maritime transportation may also be a possibility. The additional costs for logistics based on the carbon intensity of the transport may further compound the trend of transferring manufacturing closer to point of sale.

Natural resource availability is limited in many parts of the region. Many parts of Asia Pacific are affected by depletion of some resources, such as land, water, energy, and raw materials. For example, China's annual water deficit is around 40 billion cubic meters, roughly 10 times the water demand of a major city like Beijing[12] and in Bangladesh energy resources are scarce and the demand for natural gas and electricity outstrips supply. A number of interviewees in our report said they believed higher raw material costs were a bigger concern than wages.

Further compounding this trend is the number and severity of natural catastrophes that have occurred in recent years. These have disrupted supply, and some companies have been surprised by the existence of force majeure clauses in their contracts with suppliers.

Sustainability has been an effective way to enhance relationships with suppliers. Companies are working with suppliers to encourage and identify innovation, from reducing raw material use to developing new products that are more energy efficient. Innovation is increasingly occurring at the source. This is driving companies to rethink their traditional sourcing models and allowing them to develop products with less waste or inefficiency, which can improve the competitiveness of the value chain as a whole.

The buyer-supplier relationship is also changing as buyers increasingly seek to move beyond an audit approach. For over a decade, buyers have sought to control reputational and other supply chain risks through a combination of in-house and third-party auditors. These checks on working and environmental conditions in factories have had mixed results. Increasingly, companies are looking for new approaches built more around consultation, coaching, and capacity-building to motivate and support suppliers in making sustainability improvements. The ultimate goal is move from a situation of supervising and demanding standards to a proactive partnership with a common culture. Sustainability can be the glue in the relationship.

12 Society for Worldwide Interbank Financial Telecommunication

New generations, new expectations

Supply chains are also facing a fundamental shift as a new generation comes of age in Asia. This trend is most pronounced in China. Chinese companies are finding that younger workers, particularly those born after 1980, are increasingly demanding regarding their work environment. Companies have found it increasingly difficult to find labor after the Lunar New Year holidays as many migrant workers decide to stay home and not return to the eastern seaboard.

Changing demographics have implications not just for the cost of labor in China, but also how workplaces are managed. Workers who have grown up in the period of rapid economic growth bring different values and priorities to their jobs than previous generations. One Guangdong-based manufacturer recently acknowledged that its negotiations with employees were becoming more focused on work hours and conditions rather than pay levels.[13] While this is particularly visible in China, this is also a trend across much of Southeast Asia.

What are the gaps?

We believe there are some key activities that companies should undertake to assess the risk and opportunities from these drivers. These include:

- Assess options for a "beyond audit" supply chain management strategy to identify effective techniques to build ownership, capacity and incentives within the supply chain for sustainability management.
- Understand carbon intensity and the resulting costs and opportunities and assess potential impacts of bottlenecks for other resources such as water.
- Identify cost-effective methods to improve traceability and information flow within the supply chain regarding environmental information, including through the use of ICT and existing procurement platforms.
- Support suppliers' move towards greater transparency and reporting in a manner compatible with the buyer.
- Review effectiveness of existing supply chain auditing techniques and opportunities to reduce costs through collaboration with other partners or development of shared resources.
- Establish effective platforms for working with suppliers to improve the sustainability of the product over its entire life cycle, including resource consumption, waste generation, packaging use, and end-of-life disposal issues.

13 "They'd rather sleep well than work," South China Morning Post, 1 September 2011

Epic Group

Ranjan Mahtani, CEO, Epic Group

Apparel can be a volatile business, according to Ranjan Mahtani, CEO of the Epic Group. Supply chains can be fragile and companies can go in and out of business from one season to the next. "There are lots of private entrepreneurs and one or two seasons can make or break you," he remarked.

If that is the case, Epic Group has played its hands wisely, growing into a vast, vertically integrated operation, supplying brands such as Levi's, Abercrombie & Fitch, and Dockers, and retail chains including Dillard's, Marks & Spencer, J C Penney, Wal-mart, and Gap. A family-run business founded in the 1970s, it has transformed from a middleman business supplying silk garments and sweaters from southern China to an integrated manufacturing business employing over 25,000 people in its own factories in Bangladesh and Vietnam.

Epic Group can proudly claim to be among the earliest pioneers in the development of the apparel industry in Bangladesh, having set itself up in the country in the early 1980s, well before the introduction of preferential tariff rates with the EU and relaxation of foreign investment rules.

Mahtani joined the family business fresh from university and one of his first tasks was to heed the requests of US customers and seek out new low-cost locations.

"I went to Bangladesh for a three-day trip, and I stayed for three months," he said. "When I arrived, I told our customers that the production capacity was virtually non-existent, but they were interested in the long game. They said they didn't mind how long it took for us to find suppliers, so we persisted. We invested US$10,000 to set up an office there and I spent several months going around the country talking to potential suppliers, scoping out our requirements."

Mahtani's investment of time paid off and by the 1990s, he had built up a business turning over US$100 million annually. However, by now retailers had the wherewithal to buy direct while the silk industry in China was becoming increasingly commoditized. Epic needed to innovate and expand along its supply chain to stay competitive and relevant. "We realised we needed to start running the manufacturing ourselves," Mahtani explained. "We built our own 400,000 square foot factory in Bangladesh, which really raised a few eyebrows. We also invested in manufacturing in Vietnam, Sri Lanka, and Bahrain and had soon shifted completely away from China."

Today, Bangladesh is favored for many forms of garment manufacturing, especially denim. Epic has built an even larger state-of-the art, air-conditioned facility covering 750,000 square feet. "We are responsible for everything, from the operations in the factory and the welfare of our people, to the satisfaction of the final customer," he explained. "We have sales teams in the US and run our finance and marketing functions through Hong Kong."

Mahtani has no doubts that he made the right decision by betting on Bangladesh. Although it feels like the country is running at full strength right now, with the right government support and infrastructure development, he believes Bangladesh could triple its output. "Bangladesh is a tougher place to get into now. Land is more expensive and there are more regulations to navigate. Energy supplies can also be difficult to secure. We have evolved, and with our years of experience, we know how to deal with this landscape."

Wages may be among the lowest in the region, but they are also going up fast and salaries for all grades of staff were recently increased by between 15 and 40 percent. Mahtani is sympathetic to the need to keep wages competitive as the basic costs of living are also rising. "The workers in our factories are fast learners and diligent and we need to connect directly to them. Often it is the middle management that is slowest to change," he added. "Our future success will not rest on low-cost labor but on keeping our management and processes lean and effective."

The challenge is also to increase the levels of integration. Epic is doing this by investing in a self-owned dying plant and taking a majority stake in another denim factory with local partners. Prior to 2005, investment was confined to the export processing zones in Savar and Adamjee, but now it is possible to set up a wholly foreign-owned facility anywhere in the country. "We have made our bet on Bangladesh. This whole country is opening up now and with such enormous investment infrastructure, Bangladesh may be unrecognisable in five or ten years," Mahtani concluded.

Tesco International Sourcing

Christophe Roussel, Global Non-Food Sourcing & Logistics CEO, Tesco

Tesco International Sourcing initiated a major rationalization of its supplier base in 2007, and this program is now reaping benefits. "We started doing the right things at the right time," explained CEO Christophe Roussel. "Coming out of the downturn, we are stronger thanks to the power of our supplier base. It is largely due to things we started doing three or four years ago."

Roussel describes the past three years as a period of "multiple crises which needed to be navigated." These times have been just as challenging for suppliers as they have for Tesco. "We have had to help some of our suppliers through these difficult times. We showed our commitment to them and sent more business their way, and they have been able to deliver more value for us," he said.

The work never ends, as Tesco continues to review, edit, and qualify its supplier base on a cycle of 6–12 months. "We review suppliers against a set of key performance indicators, many of which are non-financial. We have people continually visiting and liaising with suppliers and we monitor suppliers according to reliability, quality and other standards," Roussel explained.

It can be a fine line between a closer relationship and one perceived as intrusive, and, for this reason, Roussel emphasized the importance of common values. "We try to treat our partners the way we like to be treated," he said. "We also want to understand how our vendors treat their employers and how receptive they are towards sustainability. We have opened carbon-neutral stores in the UK and we are aiming to halve the carbon footprint in our supply chain by 2020. Across the region, many of our vendors are enthusiastic about adopting our sustainability standards."

Tesco continues to be a pioneer in sustainability reporting, but Roussel still does not believe that anyone has discovered an ideal way to communicate environmental and social responsibility. "Being a well-known brand means we are under greater scrutiny than others," Roussel remarked. "One challenge is finding a better way to communicate the sustainability story to our customers. We are exploring approaches to labeling in much the same way food products are labeled for calories. Most consumers still don't fully understand these issues around emissions and carbon footprints, but they do expect us to do the right thing and inform them."

Water is another critical resource, and in particular it is an issue that is rising up the agenda in China. Tesco has reached a point where all of its factories in China have their own water treatment plants; Roussel cites this as another example of sustainability-related criteria in its supplier selection process.

Complexity and competitiveness in the sourcing business will continue to increase, and Roussel believes two important aspects will determine future success. "The first is deeper knowledge of products and production techniques," he explained. "The profile of our employees is changing: we expect our people to develop a greater technical understanding of our products and bring to their work experience in management techniques such as Lean manufacturing. Technology can help remove administrative costs and lower the headcount, but you need the technical knowledge."

The second critical element for Roussel is efficiency in logistics. This is particularly evident in Asian countries where logistics costs are a much larger share of GDP than they are in many mature economies. Logistics is more critical as the mix of sourcing locations is becoming more diverse. Whereas Tesco's sourcing mix used to be 80 percent from Asia and 20 percent from near-shore locations, Roussel explained that it has now shifted to 60:40.

"Logistics is the next frontier in achieving greater productivity, but it requires a longer term view," he explained. "I want to know where the future crossroads of global logistics lie and then position my supply chain around those points. Perhaps this is partly why I am a big fan of Egypt; it not only has strengths in certain products, but it also has a great geographic position. You can also look at the Silk Road and how that is opening up again. With massive investment in infrastructure, we will see new Silk Roads connecting Asia and Europe in the next five to 10 years."

KPMG viewpoints:

Trade and Customs planning in a global sourcing strategy

Sourcing products from different countries involves significant interaction with Customs and other government authorities. These authorities have varying levels of understanding regarding the relevant multilateral and regional agreements governing international trade in goods. They may not always be consistent in their application and interpretation of international rules, which may cause delays and additional costs for companies dependent on the timely delivery of their merchandize or raw materials. Thus, companies should treat customs as a complementary part of any international sourcing initiative.

Customs expenses are often mistakenly treated as unavoidable costs of doing business. In fact customs offers many avenues for direct cost savings. A better understanding of the key customs issues can help companies to identify customs risks and opportunities. Without a clear and proactive customs strategy, companies could be losing out on savings opportunities, or increasing the risks of non-compliance and penalties.

Developing an efficient customs programme can help eliminate non-dutiable costs (such as certain types of royalties), utilize Free Trade Agreements (FTAs), and identify more advantageous tariff classifications. Additionally, both sourcing locations and end destinations have various special trade zones and bonded areas which can be used to develop a duty-efficient supply chain. The incentives and regulations governing these areas change frequently, so monitoring efficiency and compliance is vital.

The inherent tension between customs and transfer pricing regimes worldwide means that considering the two areas together is fundamental to developing successful cross-border policies.

Identifying non-dutiable costs

Under the World Trade Organization valuation code, the final price actually paid or payable for goods by an importer is the value that must be declared to Customs. This includes universal additions to the price, such as royalties, as well as legal deductions. For example, certain cost elements included in the final price can be stripped out, thus lowering duty costs and, potentially, other indirect tax costs.

Non-dutiable cost elements include after-sales or post-implementation services such as training, assembly, maintenance and warranty services. Other cost elements such as finance charges, inspection fees, sales and marketing costs and certain types of commissions can also be deducted based on a review of the supplier agreements and payment structure.

Royalties

Ensuring that royalties are treated appropriately for customs purposes remains of key importance for companies moving goods with intangible value components across borders. Sourcing contracts may include specific provisions for additional charges for royalty and/or licence charges related to the goods being imported.

Goods-related royalties form part of the dutiable cost of goods, regardless of the timing of the royalty payment in relation to the importation of the goods. Goods-related royalties can be defined as those which the importer must pay, either directly or indirectly, in order to be able to sell those goods. To the extent that such payments are not already included in the price paid by the importer, these additional payments must be added to the value of the goods declared for customs purposes. Establishing suitable information systems that track royalty payments and ensure they are, where appropriate, included in the customs value of imported goods is vital for full compliance with customs requirements.

Companies paying for royalties on their imported merchandize should also consider whether any royalties paid are not 'goods-related' royalties. Removing such payments from the invoice price offers an avenue for reducing customs duty costs.

Free Trade Agreements

There are over 100 regional and bilateral FTAs offering preferential duty rates for trade between Asian states and globally. The question is whether the benefits of these preferential duty rates outweigh the internal administrative costs of complying with the country-of-origin and documentation requirements.

Exploring the FTA landscape can reveal significant reductions in duties and import-related costs and, even if a company is already claiming FTA benefits, closer examination of practices and procedures may reveal that critical compliance requirements are not being met. Early identification of non-compliance can help companies to make the changes necessary to help avoid costly customs penalties.

Tariff classification

Tariff classification, based on the physical form of the goods, determines the rate at which duty is payable at the time of import. Therefore, changing the state in which goods are imported offers the potential to change the tariff classification of declared goods and reduce the associated duty cost. For example, breaking down fully assembled goods into components, sub-assemblies or individual parts could result in the goods being subject to a different tariff classification numbers which confer more favourable tariff rates.

There are certain restrictions on this type of tariff planning so it is important to pay close attention to the rules pertaining to specific industries and tariff heading when considering this opportunity.

Special trade zones

Depending on relevant supply chain needs and the location of key markets, it may make business sense to shift assembly, manufacturing, or other hubbing activities to special customs zones or bonded parks within strategic locations in Asia. These types of programmes provide for deferment or avoidance of customs and indirect taxes for various types of business activities and could be leveraged to improve cash flow and/or reduce costs.

As the economic downturn has led companies to reevaluate locations for manufacturing and other key operations, now is an excellent time to rethink how duty free zones and customs bonded areas fit into wider supply chains.

Transfer pricing interplay

Customs and transfer pricing both focus on cross-border transactions and adopt the arm's length principle. However the drivers for each regime differ considerably. Customs valuation focuses on ensuring goods are not undervalued such that duty is under collected. Transfer pricing's focus, on the other hand, centers on checking that tax deductions are not claimed for overvalued goods purchases, thus reducing taxes payable. As such, complying with both regimes requires careful management and coordination.

As customs and transfer pricing authorities become increasingly integrated, addressing the two areas in isolation is becoming progressively more challenging. Companies need to consider implications of policies for one area on their practices in the other.

Export Controls

Another serious consideration for companies embarking into global sourcing activities, involve Export Controls. Export Controls are a system of multilateral and local policies to regulate trade in goods and technologies that are strategically controlled, or of "dual use" (for example, having both military and civilian functions).

The relevant regulations include the US Export Administration Regulations (EAR), the US International Traffic in Arms Regulations and the European Union's Wassenaar Arrangement which control both tangible and intangible products and technologies. This means that not just goods but emails, personnel access, and even office conversations are "controlled" by these regulations. Export Control Compliance involves a series of process controls, an example of which is a written manual known as an Internal Compliance Program (ICP). An ICP is developed and implemented by multinational companies that produce and import or export products and technologies, controlled by global and local Export Control programs.

Tax Efficient Supply Chain Management

Customs and indirect taxes are part of a much broader fabric known as Tax Efficient Supply Chain Management (TESCM). All of these work in concert with corporate tax, international expatriate taxation and other relevant business taxes applied on multinational enterprise activities. Thus, companies engaged in global sourcing activities are advised to coordinate their tax planning and operations planning to identify and exploit all potential cost-saving strategies.

KPMG viewpoints:

Identifying fraud risks along the supply chain

Across Asia Pacific, consumer goods companies are still confronted by significant procurement and sourcing-related fraud risks.

While there is evidence that companies are increasing the effectiveness of their internal controls to support procurement and sourcing processes, suppliers and other parties along the supply chain operate under a high degree of pressure. This pressure is further exacerbated by rising costs and the growth in consumer demand within the region, most notably in China.

While companies are seeking to address this through tighter control frameworks, many are also doing so by stepping up business collaboration (through joint ventures or subsidiaries), integrating vertically, or launching new initiatives to bring together overseas retailers and local manufacturers.

In this context, the risks around procurement and sourcing fraud continue to change. These risks remain very real and companies should be vigilant for a number red flags indicating potential fraud. These include:

- Minimal documentation relating to the chosen supplier, or details from competing supply bidders not listed in business directories. The latter can suggest that the bidder was fictitious and put into the process to make it look as if there was a competitive selection process.
- Initial bid amounts being low when the supplier was being chosen and many subsequent orders being changed or accepted at a different price than proposed. This suggests collusion with the buyer.
- The company continuing to accept high-priced, low-quality goods. This might reveal problems with the Quality Assurance department and the existence of kickbacks.

- The losing bidder being hired by the winning bidder after a supplier is chosen. This suggests collusion or indicates that the winning bidder did not have the capability to deliver the products or services when the proposal was made.

If sourcing activities are becoming more complex and spread across a greater number of parties and jurisdictions, a company could be susceptible to fraud in an even wider range of forms. These could include:

- Fictitious suppliers being set up in the company's supplier master file and payments being dispersed to them.

- Collusion existing between procurement personnel and bidders for the selection, which may involve kickbacks.

- Agents working on behalf of the company being involved in bribery or corruption. These agents may be involved in bribery or corruption to ensure that the goods satisfy customs, trade and tax import and export requirements. Of greater concern is if there is involvement of any bribery and corruption with government officials. This could potentially violate the US Foreign Corrupt Practices Act (FCPA).

- Key suppliers being related parties of the company or procurement staff.

- Failure in meeting contract specifications or suppliers passing on higher costs not in the agreement, resulting in substandard product quality and overpaying for the products sourced.

In addition to these fraud risks, companies need to ensure that goods imported and exported have valid certificates of origin, and that they are genuine and not from grey market sources.

As companies seek to identify instances of procurement fraud, some basic core internal controls can help to reduce their exposure. These include:

- Appropriate segregation of duties between the individuals that manage the supplier database and the payment function.

- Timely and standard consolidated management reporting.

- Well-documented policies, procedures, and process for supplier bidding and procurement processes.

- A single supplier database and contracts register, and a single payment address for each supplier.

- Procedures for forecasting the company's demand from suppliers and performance of exception reports and analysis.

- Audits of suppliers and assurances that supply agreements have right-to-audit clauses.

- Active data analytics of the supplier database to identify anomalies; for example, identifying common addresses of suppliers to check if there are potential related parties.

Understanding how the changing sourcing landscape may affect fraud risks, while maintaining a healthy level of skepticism over operations, can be critical to successful management of a sourcing business in Asia.

IKEA

Jesper Brodin, Regional Purchase Manager, IKEA

Jesper Brodin has been working with the Swedish retail giant IKEA for 16 years, and one of his first roles was as Country Manager for Pakistan. He spent almost three years there in the 1990s and has a fond recollection of that time, describing it as an "era of exploration, when it seemed like anything was possible."

He believes IKEA continues to have "a solid business in Pakistan, sourcing textiles from 15 or 20 producers running very big modern operations, mainly around Karachi."

Brodin left Pakistan for a similar stint running sourcing out of Indonesia and then moved back to the head office in Europe, where he reported directly to the Group CEO. Today, he heads the trading business across Asia, and his principal focus is China. The country accounts for around 25 percent of total sourcing value. IKEA has established one of its global distribution and logistics hubs in Shanghai and has invested in a Product Development Center bringing together engineering and design talent. The center opened in February 2011.

Brodin believes any sourcing company doing business in China needs to develop a long-term vision. "From our perspective we are less concerned about higher wage costs," he explained. "We see that proper wages and working conditions creates a stable workforce that in the long run leads to lower costs even when wages go up. Things are changing faster than we expected. We developed a five-year strategy outlining what we expected to happen in the market, and many of those changes have actually occurred in the space of two years."

Taking a modern view of the world means understanding the needs of consumers and other critical stakeholders. "Companies who cheat on quality or don't pay the right wages simply won't survive," he insisted. "The old school attitudes are dying, they are rejected by customers and in China they are also clearly rejected by the government in its new Five-Year Plan."

Brodin sees higher raw material costs as a bigger concern than wages. But his real focus is to develop deep, stable, and ethical relationships with suppliers, where the company can take a strong share of a producer's output, typically of between 50 and 80 percent.

This is a particularly pressing concern in China, where suppliers have the potential to pursue forward integration when the retail market booms. Brodin sees a real risk that some suppliers will turn their back on key buyers and develop their own brands to sell products directly into the growing domestic market. "It is no longer only a buyer's market," Brodin commented. "You need to really understand your partner's strategy and what their priorities are to manage a range of commercial risks. As a sourcing business, what are the values that you can provide to them, which will encourage them to stand by you in a tight supply environment?" he questioned.

IKEA is very focused on making things easy, and therefore more efficient and profitable for its suppliers. "We drive efficiency by developing our product range based on the preconditions on the factory floor. Design is not a remote process, but closely linked to what is practical and what will minimise waste. That benefits everyone, including the end customer who can be sure our products are practical, reliable and produced in a sustainable way."

When asked whether he expects more trips back to Indonesia or Pakistan, Brodin is ambivalent. "The geographical location is no longer the main driver for sourcing," he explained. "The opportunity is to find the right people with the right industrial knowledge that we want to work with. It could be anywhere. Once you have established that you can put production where it will be optimal. That could mean working with a Swedish-owned factory in China or a Chinese-owned manufacturer in Poland. This is how the business cuts across borders today."

s.Oliver

Bernd Hanemann, COO, s.Oliver

With a substantial sourcing operation extending across Asia Pacific, German-based retail group s.Oliver sees itself not just as a buyer but also a specialist producer, with a high degree of attention to detail for fashion and fabric R&D.

"In a retail market seeing relatively flat growth (at home in Germany), we have taken a steadily growing share and last year our sales hit EUR1.2 billion," said Bernd Hanemann, based in Hong Kong. "We attribute this success to original designs with finishing touches that people love. To achieve this, we have to be very much on top of the production process. You can go cheap for a while, but ultimately you lose out if you don't maintain quality and keep inspiring your customers."

With 12 new lines each year, a collaborative approach is critical. The creative inspiration for s.Oliver's products may come from its head office in Europe, but the R&D of fabrics and yarns is occurring in Asia. It is illustrative of the closeness of the involvement with suppliers that the company will often select very specific fabrics and provide those directly to the producer to use.

Hanemann believes s.Oliver is in a good position to ride out the current volatility because of these close supplier relationships. "I have only been in the role of COO for less than a year, but my predecessor did a great job in establishing consistency in our ordering, communicating with suppliers, helping them plan and being a predictable partner for them. I think our suppliers appreciate our fairness and when supply tightens, that puts us in a good position," he explained.

However, Hanemann is not so sure of the future for some suppliers who are grappling with higher costs, noting that "We saw some manufacturers hitting the wall a couple of years ago. It may not be as dramatic as that, but there will be people fighting for survival over the coming year or two. We may see a bit of a shake-out."

s.Oliver produces mainly in China, Indonesia, India, Bangladesh, and Turkey, and has offices in all these locations. While Hanemann said that "we have always been well-spread across these locations," he also emphasized that the company has a relatively concentrated list of suppliers, because of the time and effort required to develop their close collaborative relationships.

The supplier situation is especially tough in China, as Hanemann conceded that labor has become far harder to find and hold on to. "In China, you have a situation where workers don't come back after the holidays (especially Chinese New Year). They have more opportunities and greater expectations for their lives. It can be a problem because we need people who know what they are doing. But these things aren't such a surprise now as they were one or two years ago. Now, it is just another thing to deal with."

Yet if the situation in China is so tough, does Hanemann believe that the Indian subcontinent provides the answer? He notes that quality from Bangladesh producers is rising. "We opened our office in Bangladesh in 2004 and it proved to be absolutely the right thing to do. Some were sceptical, but with quotas being lifted, we entered at a good time," he said. "India is also strong in certain areas of production and will remain a very important location for us."

KPMG viewpoints:

Tax considerations when restructuring the sourcing model

Many sourcing companies with headquarters in Europe and North America maintain a three-tier structure, with a regional headquarters to cover procurement and support functions and smaller representative offices in China and other Asian countries to carry out day-to-day liaison with suppliers. The location of the procurement entity is influenced by many commercial and legal factors. In Asia Pacific, the two most popular locations are Hong Kong and Singapore. Both have a centralized geographic location, well developed ports and low tax rates. Hong Kong is seen as a gateway to the Chinese market and Singapore is well positioned within Southeast Asia and offers specific tax incentives to groups who wish to establish operations in Singapore, for example, the Global Traders Programme which can reduce the tax rate to 10 or 5 percent.

For the past two decades, China has been the primary choice for companies to source consumer goods, because of the low labor costs and the scaleability of production, while South and Southeast Asia have been important centers for textiles, footwear, and certain electronics products. With sourcing companies encountering increased cost pressure, we have witnessed some looking more closely at new sourcing locations such as India, Bangladesh and Vietnam. Nevertheless, these sourcing companies are still heavily reliant on the Chinese suppliers, because no other country can match China's scale, at least in the near term. We foresee that sourcing companies will continue to develop new sourcing locations and alter their current supply chain and logistic arrangements.

From an operational standpoint, sourcing companies have also encountered regulatory and tax changes. In 2010, the Chinese government issued a new regulation to restrict to four the number of foreign expatriates each representative office can maintain. With this new change, the companies have to convert their representative offices into wholly foreign owned enterprises (WFOEs) in China. This has created a change of overall tax and administrative costs for the group, because representative offices are usually taxed-based on a total cost-plus method, while the WFOEs are taxed-based on actual profits. At the same time, the Chinese tax authorities have strengthened tax enforcement and scrutiny on non-resident enterprise concerning the existence of permanent establishments of overseas enterprises. For those sourcing companies that still maintain representative offices in China, the Chinese tax authorities are becoming more interested in understanding the roles and responsibilities of representative offices, as they noticed that they are no longer only for liaison purposes; they are also handling functions such as sampling, testing, and marketing. The Chinese tax authorities are interested in understanding whether the magnitude of value contributed by the representative office is in proportion to the profits attributed to the representative offices, which should be taxed in China, rather than in Hong Kong or overseas.

While many companies have changed their mainland China entities into WFOEs, in other countries the rep office model may still be the norm. These rep offices may also start to take more of a role in the value chain, requiring a reassessment of tax implications in that location.

Sourcing activities can present multinational groups with complex transfer pricing challenges. Specifically, centralizing purchasing power and streamlining the number of suppliers can provide opportunities for multinational groups to capture lower prices and realize savings – and the allocation of these savings is beginning to attract the attention of tax authorities, particularly those in European jurisdictions who have observed the erosion of their tax base when these savings are predominantly allocated to Asian procurement entities.

Tax savings can arise because the sourcing company forms a strategic component in the supply chain that contributes significantly to the performance of the group. In this case, it is arguably appropriate that a portion of the savings associated with centralized procurement reside with the procurement entity. In contrast, where the procurement entity merely consolidates orders and executes contracts from multiple affiliates, the savings may instead need to be apportioned between those affiliates placing the orders so as to satisfy the arm's-length principle. Whether the procurement entity takes legal title to the procured products also has important implications (as tax authorities frequently evaluate the profitability of an enterprise as a first step in a transfer pricing analysis) and whether or not the value of the procured products falls in the profit and loss statement of the procurement company has a significant impact on its cost base.

The analysis is further complicated when there are multiple representative offices undertaking procurement process in numerous Asian jurisdictions. The remuneration of these entities also needs to be evaluated for tax exposures. In China, we have observed the tax authorities transition from accepting a cost-plus remuneration policy for representative offices to successfully arguing that a profit-split methodology is a more appropriate remuneration mechanism, effectively resulting in additional profits being subject to tax within the country.

As procurement strategies continue to evolve and tiered structures become more common, it will become increasingly vital that multinational groups give due consideration to the tax and transfer pricing implications of their decisions, especially when entities are established in jurisdictions with more favorable tax rates such as Singapore and Hong Kong.

Kingfisher Sourcing

Anthony Sutcliffe, Group Sourcing Director, Kingfisher Sourcing

"Sourcing is about driving sales through better, more innovative products and increasing margins by managing the whole process better," said Anthony Sutcliffe, Group Sourcing Director for Kingfisher, the name behind home improvement brands including B&Q in the UK, and Castorama and Brico Depot in France. "This is how the sourcing strategy must support the corporate strategy. It seems common sense to say it, but you need to work at it to make sure it is always the reality."

Sutcliffe explained that Kingfisher's overall sales have been relatively flat over the past two years, due to tough market conditions in the UK, yet profitability has risen 80 percent. Sourcing was identified as one of seven strategic levers for improving the bottom line and can take some credit for this improving state of affairs.

"The story of the last three years has been transformation. It has been about harmonising our operations as a group, and aligning strategies from both a product and a vendor perspective," Sutcliffe explained. "At one time, B&Q (in the UK) was the dominant part of the business, but today it accounts for 40 percent of sales. It has become a less dominant part of the overall group as we have expanded in mainland Europe and in other markets. It is a great opportunity for us at a time when we are focused on optimising our sourcing activities across the group as a whole."

With 18 years' experience in the retail industry, 13 of those in Asia, Sutcliffe joined Kingfisher from UK retailer Boots just as the group was demerging many of its retail businesses and focusing purely on home improvement. He became General Manager for Sourcing in 2003 and Global Sourcing Director in 2006.

Sutcliffe believes the harmonization of products across the retail divisions has helped as Kingfisher expanded into new markets from China to Russia to Poland. "From cheaper or promotional ranges, we are now sourcing more for full solutions in the bathroom, kitchen or living room," he explained. "We are also more focused on the finishing touches in terms of furnishings, lighting and flooring, adding more of a fashion element. We can see that 50 to 80 percent of tastes are the same wherever you are in the world, and we are becoming more effective at bringing existing ranges into our new emerging markets."

Although Kingfisher still purchases around 75 percent of its directly sourced products from China, Sutcliffe has seen new regions developing specializations and strong competitive alternatives. Eastern Europe is a strong source for softer timbers, which are ideal for flooring and building materials, while India is strong for decorative textiles used in furnishings. Sutcliffe admitted to being slightly surprised to find India also emerging as a source for shaped metalware, such as lighting fixtures. Meanwhile, he has seen sources in the Middle East and Mediterranean provide innovative ceramic products. "Two or three years ago, all our ceramic tiles were sourced from Asia, but today that is down to 50 percent," he explained. "We have found suppliers in the UAE, Turkey, and Spain who are extremely innovative and creative and who have their raw materials close at hand. Innovation is occurring at the source and this is also driving us to rethink our traditional sourcing models."

Back in China, Sutcliffe has seen suppliers moving up the value chain, something he welcomes, as he believes China cannot avoid certain challenges ahead. "China has always been able to compete in absolute volumes, but as retailers push for lower order quantities and more flexible approaches to inventory, this volume advantage may be less relevant. China is starting to move to better protect intellectual property and to innovate in terms of operational configurations. China remains the manufacturing venue of choice for the near future, but as the historical price advantage erodes, these other considerations will become more prominent."

Sutcliffe believes China has helped consumers worldwide enjoy more affordable products over the past decade. "Now, maybe that position is less clear than it has been in recent years, which is why innovation and being different will play an increasingly important role in future sourcing strategies," he concluded.

Global Sources

Merle A Hinrichs, Chairman and CEO, Global Sources

When Merle A Hinrichs founded Global Sources in 1970, the four Asian Tigers (Hong Kong, Korea, Singapore, and Taiwan) were taking off as exporting powerhouses. Global Sources created a platform to promote cross-border trade, particularly for exports of garments, toys, and electronics from Asia. Having worked for many years with a trade publisher in Japan, Hinrichs saw how production was shifting and how he could help Western buyers navigate new markets.

"I moved to Japan in the 1960s after finishing business school, at a time when exports were driving the country's post-War regeneration," Hinrichs explained. "Importers could not buy from Japan without full letters of credit. These letters were the financing miracle behind Japan's recovery after World War II. By the 1970s, Korea was already following Japan's model of export-driven growth."

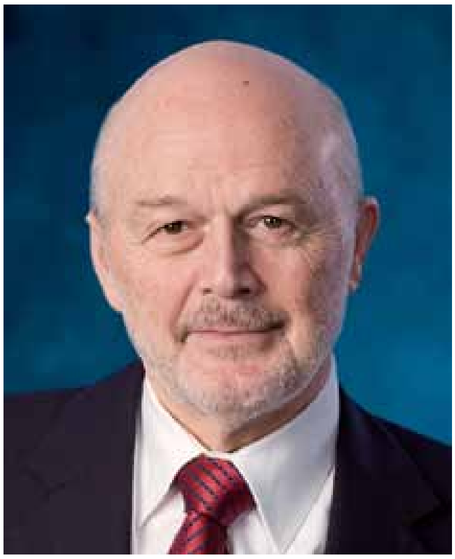
Hinrichs has seen many subsequent shifts. "Manufacturers tend to relocate in waves as they seek out new lower cost locations," he explained. "China's miracle was its ability to lure foreign direct investment (FDI) to help build the manufacturing base virtually from scratch. Once a few big manufacturers had set up in China, others couldn't afford not to follow suit. This was not so much the China miracle as the FDI miracle. Now, Chinese companies are themselves relocating to cheaper locations, or looking for ways to move up the value chain, just as Japanese companies like Sony did in the 1970s and 1980s."

Today, Hinrichs sees fresh challenges for suppliers and sourcing businesses. He believes meeting quality standards is now the key barrier to overcome, particularly when relocating. In addition, infrastructure factors such as reliability of energy supply are still concerns in many parts of the region. "At the end of the day, sourcing is about buying the right product at the right price. Some companies are fundamentally better at doing this than others," he said. "In the current market, companies that are not good buyers simply won't survive. Sometimes you can see where things are going and which companies are getting themselves into trouble."

Global Sources is essentially a publisher and exhibition organizer and, since the 1990s, a key interface has been its internet portals. In the early years of the web, building content was like building market share – critical to survival. Over the longer term, the emphasis had to be on quality and customer service. Global Sources qualifies suppliers listed on its vertical websites and provides hands-on support through the discovery process. Hinrichs observed, "There is (now) more onus on import wholesalers to take liability for product quality and warranties."

From a service standpoint, Global Sources has a tiered approach; its vertical websites and trade magazines reach the widest audience, while China Sourcing Fairs and Private Sourcing Events generate fewer – yet higher quality – sales leads. Hinrichs sees the biggest 20 percent of importers buying 80 percent of the volumes. "If we can meet their needs (and apply the same standards), then we know we can satisfy the other 80 percent as well," he remarked.

The company's sourcing fairs are organized not only in China and Southeast Asia, but also as far afield as Mumbai, Dubai, Johannesburg, and Miami. Hinrichs sees the fairs as the other vital part of the business model. "Our trade shows are important to get people in front of each other and establish that trust and credibility. In any business arrangement, there has to be chemistry," he added. "When people meet, each person has different validation needs."



In the coming years, Hinrichs believes companies will face rising costs, whether they go offshore or stay in China. "Overall we can see China exporting inflation with the implication that costs such as wages will rise elsewhere. We may see some consumer resistance, but ultimately the higher prices will reach the consumer," he said.

Hinrichs believes China's government is well aware of this long-term trend. "They realise that production is commoditised and that they can capture more value by moving up the value chain," he said. Developing design talent could be the next step. He stated that companies that treat design as a strategic asset will achieve a higher return on their investments.

KPMG viewpoints:

The role of technology in unleashing further value

As many of the case studies in this report illustrate, competition between companies no longer rests solely upon the cost of quality of products and services, but also upon the efficiency and effectiveness of supply chains.

For the past three decades, improvements in Asian supply chains have allowed the region's factories to supply an ever-greater variety of products, of higher quality, and with lower prices. Product life cycles have shortened and supply chain management advances have allowed just-in-time manufacturing and modularization.

Value networks, comprising upstream and downstream partners working in collaboration, are being redefined. Many factories in coastal regions of China are sizing up the benefits of shifting to other inner regional provinces of China or alternatively, to lower cost markets such as Bangladesh, India and Vietnam. For these companies, the entire value network will determine which locations succeed, and which will not.

Information systems are critical to the effectiveness of logistics infrastructure as Information Technology (IT) can allow manufacturing, production and distribution to be interconnected in an unprecedented way. With the right systems and platforms, it is increasingly possible to dissect manufacturing processes between different components, stages and locations.

At one extreme, this can allow an unprecedented level of transparency around costs along the supply chain. The largest buyers now have the leverage to demand high levels of visibility over the operations of suppliers. Technology gives them the practical means to achieve that visibility. In return, they provide assistance to their preferred buyers on how to further enhance their businesses, drive efficiencies and operate more sustainably.

In addition, technology can help to ease strain by facilitating steps throughout the procurement cycle. Electronic procurement platforms, whether hosted on the Internet or other media such as EDI (Electronic Data Interchange) or Enterprise Integrations (formerly known as EAI), have aided organizations in streamlining their entire purchasing process. They allow organizations to connect to vendor catalogues, generate requisitions, use sophisticated workflow tolls for approval processing and deliver purchase orders to suppliers electronically. In this respect, there are opportunities for enhancement in key processes spanning purchase requisition, requisition approval, workflow management, purchase order creation, receiving and reconciliation, and reporting and analysis.

Successful sourcing businesses are developing a monitoring presence that improves overall supply chain coordination, including compliance with technical and quality requirements, cycle time planning, lead times, demand forecasting and production schedules.

Partly as a response to the recent economic downturn, many organizations have made significant investments in technology to enable their procurement process and lighten their inventory burden. While some have reached the appropriate balance on cost, return and risks, some are still facing the challenge of identifying the appropriate technology investments, determining how much is enough and more importantly, aligning the technology investment with the overall procurement strategy.

While technology plays a key role in sourcing, an adaptable and continually improving procurement process is equally important. If processes are inefficient, or there is excessive manual intervention, organizations will struggle to realize value from procurement. Some organizations have been able to standardize and optimize the procurement process and share best practices while leveraging technology. The ability to respond and adapt to the changing sourcing environment is the real business differentiator.

Country snapshots

Bangladesh

Population	164 million	
Median age	25	
GDP	US$105.4 billion	
GDP per capita	US$1,566	
Manufacturing as % of GDP	18%	
Container ports	Largest container port is Chittagong, 83rd largest in the world.	
Trade agreements	Asia-Pacific Trade Agreement South Asian Free Trade Area	
Export destinations	1. European Union (27)	51.2%
	2. United States	25.7%
	3. India	4.0%
	4. Canada	3.5%
	5. China	1.7%

Cambodia

Population	14 million	
Median age	22	
GDP	US$11.4 billion	
GDP per capita	US$2,086	
Manufacturing as % of GDP	15%	
Container ports	Largest container port is Sihanoukville	
Trade agreements	FTA memberships ASEAN Free Trade Area Regional agreements ASEAN economic cooperation agreements with Australia and New Zealand, India, Japan, Korea and China	
Export destinations	1. United States	45.2%
	2. Hong Kong SAR, China	19.3%
	3. European Union (27)	17.4%
	4. Canada	6.7%
	5. Vietnam	3.9%

China

Population	1,338 million	
Median age	34	
GDP	US$5,745 billion	
GDP per capita	US$7,518	
Manufacturing as % of GDP	34%	
Container ports	Shanghai is the largest container port in the world and China has nine ports among the top 50 (not including Hong Kong)	
Trade agreements	FTA memberships ASEAN Free Trade Area Regional agreements ASEAN-People's Republic of China Comprehensive Economic Cooperation Agreement Asia-Pacific Trade Agreement Bilateral agreements: Hong Kong, Macau, Pakistan, Peru, New Zealand, Singapore	
Export destinations	1. European Union (27)	19.7%
	2. United States	18.4%
	3. Hong Kong SAR	13.8%
	4. Japan	8.1%
	5. Republic of Korea	4.5%

India

Population	1,171 million	
Median age	25	
GDP	US$1,430 billion	
GDP per capita	US$3,291	
Manufacturing as % of GDP	16%	
Container ports	Largest container port is Nhava Sheva, 26th largest in the world.	
Trade agreements	FTA memberships South Asian Free Trade Area Regional agreements ASEAN-India Comprehensive Economic Cooperation Agreement India-MERCOSUR Preferential Trade Agreement Bilateral agreements: Afghanistan, Bhutan, Chile, Korea, Nepal, Singapore, Sri Lanka	
Export destinations	1. European Union (27)	20.5%
	2. United Arab Emirates	14.4%
	3. United States	10.8%
	4. China	5.9%
	5. Hong Kong SAR, China	4.0%

Indonesia

Population	233 million	
Median age	28	
GDP	US$695 billion	
GDP per capita	US$4,380	
Manufacturing as % of GDP	27%	
Container ports	Largest container port is Jakarta, 24th largest in the world.	
Trade agreements	FTA memberships ASEAN Free Trade Area Regional agreements ASEAN economic cooperation agreements with Australia and New Zealand, India, Japan, Korea and China Bilateral agreements: Japan	
Export destinations	1. Japan	15.9%
	2. European Union (27)	11.7%
	3. China	9.9%
	4. United States	9.3%
	5. Singapore	8.8%

Malaysia

Population	28 million	
Median age	26	
GDP	US$219 billion	
GDP per capita	US$14,603	
Manufacturing as % of GDP	25%	
Container ports	Two container ports, Port Kelang and Tanjung Pelepas, are the 13th and 16th largest in the world.	
Trade agreements	FTA memberships ASEAN Free Trade Area Regional agreements ASEAN economic cooperation agreements with Australia and New Zealand, India, Japan, Korea and China Bilateral agreements Japan, New Zealand, Pakistan	
Export destinations	1. Singapore	14.0%
	2. China	12.2%
	3. United States	11.0%
	4. European Union (27)	10.9%
	5. Japan	9.8%

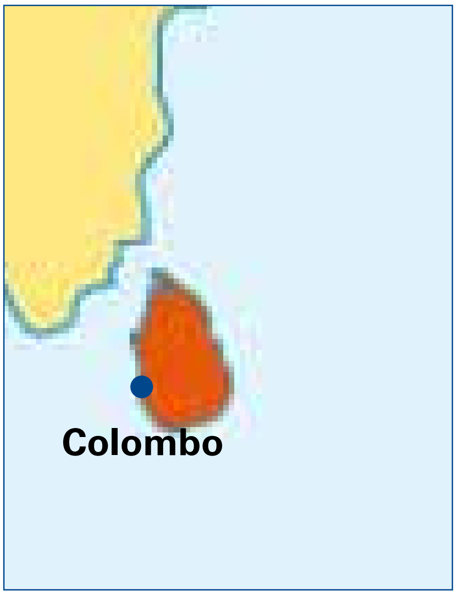
Pakistan

Population	173 million	
Median age	21	
GDP	US$174.8 billion	
GDP per capita	US$2,790	
Manufacturing as % of GDP	17%	
Container ports	Largest container port is Karachi, 74th largest in the world.	
Trade agreements	FTA memberships South Asian Free Trade Area Bilateral agreements China, Iran, Malaysia, Mauritius, Sri Lanka	
Export destinations	1. European Union (27)	24.6%
	2. United States	18.3%
	3. United Arab Emirates	8.8%
	4. Afghanistan	7.8%
	5. China	5.7%

Philippines

Population	94 million	
Median age	23	
GDP	US$189.1 billion	
GDP per capita	US$3,726	
Manufacturing as % of GDP	20%	
Container ports	Largest container port is Manila, 37th largest in the world.	
Trade agreements	FTA memberships ASEAN Free Trade Area Regional agreements ASEAN economic cooperation agreements with Australia and New Zealand, India, Japan, Korea and China Bilateral agreements Japan	
Export destinations	1. European Union (27)	20.7%
	2. United States	17.7%
	3. Japan	16.2%
	4. Hong Kong SAR, China	8.4%
	5. China	7.6%

Sri Lanka



Population	20 million	
Median age	31	
GDP	US$48.2 billion	
GDP per capita	US$5,104	
Manufacturing as % of GDP	18%	
Container ports	Largest container port is Colombo, 29th largest in the world.	
Trade agreements	FTA memberships South Asian Free Trade Area Regional agreements Asia-Pacific Trade Agreement Bilateral agreements: India, Pakistan	
Export destinations	1. European Union (27)	36.9%
	2. United States	23.1%
	3. India	5.1%
	4. United Arab Emirates	3.1%
	5. Russian Federation	2.7%

Thailand

Population	68 million	
Median age	33	
GDP	US$312.6 billion	
GDP per capita	US$8,644	
Manufacturing as % of GDP	34%	
Container ports	Largest container port is Laem Chabang, 22nd largest in the world.	
Trade agreements	FTA memberships ASEAN Free Trade Area Regional agreements ASEAN economic cooperation agreements with Australia and New Zealand, India, Japan, Korea and China Bilateral agreements Australia, China, Japan, Laos, New Zealand	
Export destinations	1. European Union (27)	11.9%
	2. United States	10.9%
	3. China	10.6%
	4. Japan	10.3%
	5. Hong Kong SAR, China	6.2%

Vietnam

Population	88 million	
Median age	29	
GDP	US$102 billion	
GDP per capita	US$3,123	
Manufacturing as % of GDP	20%	
Container ports	Largest container port is Ho Chi Minh, 28th largest in the world.	
Trade agreements	FTA memberships ASEAN Free Trade Area Regional agreements ASEAN economic cooperation agreements with Australia and New Zealand, India, Japan, Korea and China Bilateral agreements: Japan	
Export destinations	1. United States	19.0%
	2. European Union (27)	17.4%
	3. Japan	13.5%
	4. China	7.7%
	5. Australia	6.9%

Sources for country data:

GDP, GDP per capita: IMF (2010)
Median Age: UN Population Division (2010)
Population (2010), Manufacturing as % of GDP (2009): World Bank
Container ports information: World Shipping Council (2011)
Export Desitinations: World Trade Organisation (2009)

Glossary

ASEAN	Association of Southeast Asian Nations
COGS	Cost of goods sold
CSR	Corporate social responsibility
DSO	Days sales outstanding (the number of days needed to turn receivables into cash)
FOB	Free on board (usually indicates that the seller covers delivery to, and loading costs at, the port of export)
FTA	Free trade agreement
FTZ	Free trade zone
GSP	General system of preferences
LC (LOC)	Letter of credit
MOQ	Minimum order quantities
OEM	Original equipment manufacturer
R&D	Research and development
RMB	Renminbi, China's currency; also referred to as the yuan (CNY)
TEU	Twenty-foot equivalent unit, a standard measure in container transportation

Case studies index

About KPMG

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Current publications

CFO Insights: A global survey of Consumer Markets executives

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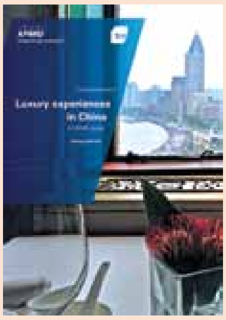
Measuring Up: Improving sustainability in Consumer Markets



Luxury Experiences in China: A KPMG study

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