

How to build better relationships in China

Your usual ways of doing business and managing suppliers may not be effective in China. Here's advice on developing and maintaining strong supplier partnerships in this important trading nation.

MANY COMPANIES ARE STRUGGLING with sourcing in China today. Reduced demand in Western markets, rising labor and energy costs, concerns about quality, and similar issues are stressing supplier relationships like never before. As a result, companies are finding that even if they have the right suppliers and are employing good management systems, sourcing in China may not provide as great a cost advantage as they expected.

One way to respond to these pressures is to have an effective supplier relationship management (SRM) program in place. SRM is an approach to managing interactions between a company and the organizations that supply the goods and services it uses. Effective supplier relationship management can help companies become more competitive by making their supply chains more efficient, stable, and flexible.

To be sure, building effective relationships all along the supply chain is key to achieving superior sourcing performance. But in today's global economy, China plays a critical role in the *buy* and *make* segments at the beginning of the supply chain. (Figure 1 shows the context for these supply chain processes.) For that reason, this article will apply mostly to those two areas. It will describe the stresses that companies sourcing in China are experiencing, the factors behind those stress points, and how applying SRM in a way that is

appropriate to China's culture and business environment can support mutually beneficial buyer-supplier partnerships.

Buyers respond to change

There are many reasons why Western buyers are having trouble in China. For one thing, many have taken too casual an approach to developing their sourcing operations. They often are too opportunistic in selecting products and suppliers and do not conduct adequate due diligence. They also may only consider first cost instead of total delivered cost and have insufficient resources to manage supplier qualification, quality control, and logistics support. The result for many of these companies has been:

- Poor delivery in terms of speed and consistency;
- Inconsistent product quality;
- Lack of bargaining power on pricing;
- Too many people, or touch points, involved in transactions;
- Inefficient and slow product development and design process;
- Communication breakdowns leading to strained relationships with suppliers;
- Lack of a meaningful supplier management system and supplier improvement processes;
- Poor logistics from a dispersed base of suppliers; and
- A sourcing strategy that is not aligned with the company's global supply chain.

Recent dynamics in both the global

[BY STEVEN GANSTER]

marketplace and within China are adding further complexity. The dramatic drop in demand in the developed markets has sent shock waves into China's supplier base, with many companies going bankrupt or severely weakened financially. To make matters worse, suppliers now need to comply with the new 2008 labor law that requires employers to pay certain benefits, severance requirements, and overtime, which has raised labor costs. During the last two years, the government has significantly reduced rebate levels on the value-added tax (VAT), which has further eroded profits for exporters. (The government recently restored some of these subsidies in response to the troubled economic environment.) Figure 2 outlines some recent changes and their impact on sourcing.

Because of momentous changes in the global business landscape, strategies that were effective a year or two ago may no longer make sense. Companies may now find themselves with too many or the wrong suppliers in too many locations, supported by a weak procurement strategy, inefficient processes, and poor technology.

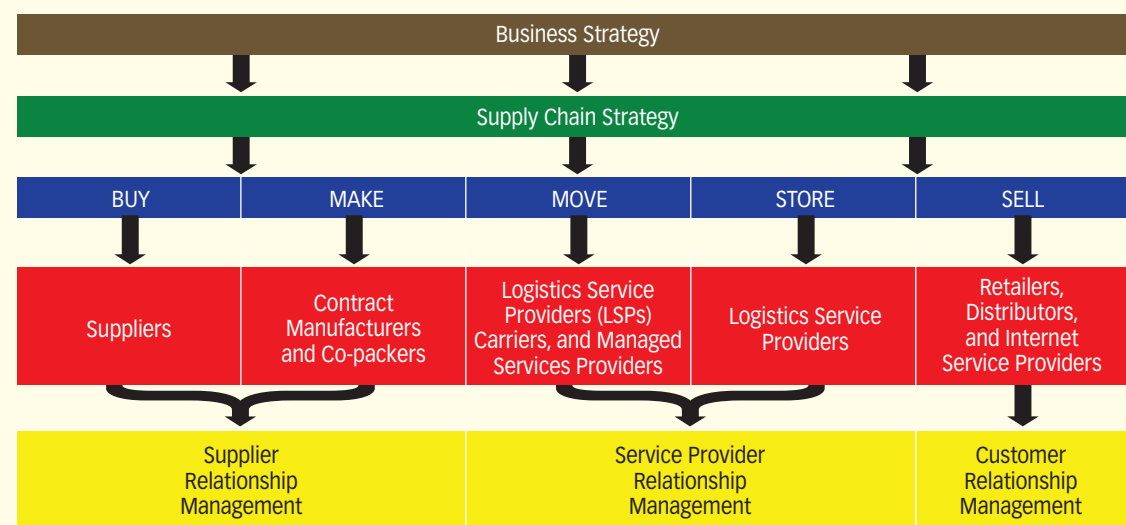
Some buyers are questioning whether China will be a competitive source in the future. Others are considering abandoning China altogether. While leaving China has been a good solution for some firms, many have found that other low-cost countries, such as Vietnam, are not the safe havens they had anticipated. For example, Vietnam's poor infrastructure, weak domestic supply chain, crude business and legal environment, and frequent labor strikes often offset its advantages of lower taxes and hourly wages.

For many companies, China's massive domestic market, improving infrastructure, and increasingly stable supply chain present a compelling case to stay put. Yet the business challenges outlined above require an active response if companies are to profitably continue in that market. That means looking for ways to improve supply chain performance and costs. Some of the tactics companies are employing right now include:

- Increasing a company's total buy in China (and other parts of Asia) to achieve scale and improve productivity;
- Localizing more sourcing functions (for example, by locating product development in China and taking advantage of its wealth of technical talent);
- Diversifying geographic locations within China (for example, shifting to a supplier base in central provinces like Sichuan, where costs are lower);
- Establishing a regional consolidation center to improve efficiencies, lower costs, and streamline logistics;
- Eliminating the middleman or third party in their sourcing structure to enhance transparency along the whole supply chain and reduce redundant costs;
- Investing in better logistics and information systems;
- Better integrating sourcing in China and Asia with the company's global supply chain; and
- Re-evaluating supplier portfolios and relationships with key suppliers.

It is in this last area that supplier relationship management can be especially valuable. Using SRM, companies can improve relationships with their Chinese suppliers and address those suppliers' stress

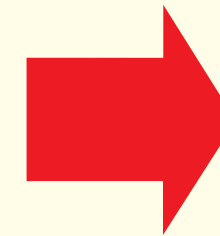
[FIGURE 1] THE CONTEXT FOR SUPPLY CHAIN PARTNERSHIPS



[FIGURE 2] CHINA'S CHANGING BUSINESS LANDSCAPE

Recent Changes

- Reduction in value-added tax (VAT) rebate
- Renminbi (RMB) appreciation
- New labor law
- Quality problems
- Rising raw material and energy costs
- Rising shipping costs
- Shift of manufacturing to Western China
- Global economic slowdown



Impact on Sourcing

- Sourcing retrenchment
- Reconsidering geographic locations
- Evaluating product stock-keeping units (SKUs)
- Re-evaluating processes
- Adjusting supplier portfolio
- Rethinking supplier relationships
- Considering alternative logistics structures and routes

points. By doing so, they can be competitive in China's changing business environment while increasing their supply chain's efficiency, stability, and flexibility.

Focus on relationships

Supplier relationship management is an approach to structuring and managing relationships between buyers and their suppliers. SRM is not about a company lining up all of its suppliers and forcing them through a software implementation, nor is it a simple certification process or a rating scheme. Rather, it is a process of continuous improvement that encompasses business practices, software, personal communication, and relationships at multiple levels of the organization. It creates a common frame of reference that enables effective communication between an enterprise and suppliers that may use quite different business practices and terminology and have very different cultural paradigms. Accordingly, SRM increases the efficiency of processes associated with acquiring goods and services, managing inventory, and processing materials.

In the North American business arena, SRM is often perceived as a software-based approach to managing relationships and communications. But when companies enter developing markets like China, SRM ceases to be mainly about implementing software to impose uniformity and provide efficiencies. Instead of focusing on the "management" part of supplier relationship management, the key word in China is "relationship." Put another way, in China and many other parts of Asia, a buyer-supplier relationship is viewed as a marriage, whereas in North America, it can be more like dating—or even a one-night stand in some cases.

Companies that successfully implement SRM in Asia tend to have many of the following characteristics:

- They have a formal process for finding, qualifying,

and certifying Asian suppliers;

- They prioritize suppliers so that the most significant are given the most attention;
- They keep core suppliers in tune with the company's strategy and vision;
- Their senior management frequently visits with suppliers and pursues one-on-one relationship building, often through after-hours social events;
- They review performance regularly at all levels;
- They have appropriate business intelligence and support resources on the ground;
- They have a formal supplier improvement plan; and
- They seek to change suppliers' behavior, not just specific processes.

Even the best SRM process will not be effective if a company's sourcing strategy is not right to begin with. Companies that get it right believe in "strategy before structure"—in other words, before they ever begin putting supplier relationships in place, they view Asian sourcing strategically and align it with corporate goals for growth and profitability. They consider total delivered cost, not just first cost. Then they make sure they have the right suppliers in the right place in the right type of relationship. They also back up their sourcing philosophy with careful execution—by religiously conducting due diligence. In today's turbulent market environment, it is especially critical to achieve this strategic alignment and abide by a rigorous due diligence process.

Culture and communication

As the list of success attributes suggests, communication is the cornerstone of a successful SRM initiative in Asia. The cultural focus on "relationship" rather than on "management" means that people place a premium on interpersonal communication. Because Chinese and Western styles of communication are very different, Western managers can face some sig-

nificant challenges when it comes to building quality, lasting relationships with Chinese suppliers.

While it is not possible to explain every aspect of intercultural communication here, we can provide a brief overview of some of the most important differences we have encountered when working with Chinese suppliers and their Western customers. It is critical that buyers understand these differences and keep them in mind as they conduct negotiations, collaborate, and build rapport with their suppliers.

First and foremost, North Americans and Northern Europeans approach relationships very differently than the Chinese. Sociologists refer to North Americans and Northern Europeans as “low-context communicators.” Low-context communicators tend to play by external rules. Knowledge is codified, public, external, and accessible. People think of different aspects of life—relationships, activities, time, space—as being discrete and separate from each other, and interactions tend to be impersonal and of

short duration. In these task-centered cultures, knowledge is more easily transferable than in some other cultures.

The Chinese, on the other hand, are “high-context communicators,” with a communication style that is vastly different than that in the West. It is much less explicit and requires a more internalized understanding of what is being communicated. Knowledge is not necessarily factual—that is, viewed as being objective, undeniable fact. Instead it can be interpreted differently based on the situation or the relationship. Moreover, relationships in China are complex and often include multiple intersections with others, unlike the more straight-line relationship structure that is typical in the West (see Figure 3 for a graphic representation). For example, one person might know another in several different contexts through business, personal connections, or both. These multiple connections foster long-term relationships. Most importantly, decisions and activities require some per-

sonal face-to-face interactions, not just communication via e-mail, fax, or the phone.

This dichotomy between communication styles can cause important communication gaps. For instance, a Chinese supplier may state that he will “try to meet the shipping deadline.” An American would understand that to mean that the supplier will do his utmost to ship the order on time. But in fact the supplier is politely communicating, “There is no way I can do it.” Chinese culture places a high value on addressing concerns indirectly, avoiding public criticism or humiliation (often referred to as “saving face”), and avoiding confrontation in relationships. All of those cultural norms, of course, come into play during negotiations between buyers and suppliers. This is just one example of why buyers need to translate communications with their Chinese suppliers not just linguistically but also culturally—understanding not only *what* they are saying but also *how* they are saying it.

The hierarchy of relationships also has a great influence on the way buyers and suppliers work together. In the United States, there is a strong belief that inequality in society should be minimized; everyone should have equal rights. Americans believe that hierarchies should only be established for convenience or efficiency, and they should not be seen as the natural order of things. Americans also believe that their superiors should be accessible and approachable. In China, however, people accept and depend on hierarchical relationships. The supervisor is expected to be more knowledgeable than his or her subordinates, and he or she should never be criticized. Furthermore, power holders are entitled to privileges. Hierarchy ensures inequality, and this is the natural order of things.

Given these differences in communication styles and individual rights and authority, there are bound to be misunderstandings when Western buyers and Chinese suppliers conduct negotiations and discuss mutual expectations—no matter how sincere an effort both parties make. Overcoming these challenges requires a commitment by the buyer’s senior managers to spend enough time meeting face-to-face with their Chinese counterparts to cultivate strong relationships and work through cultural differences. Where there is a high level of trust and respect between buyer and supplier, the likelihood of cooperation, transparency, good performance, and mutual financial benefit greatly increases.

Voice of the supplier

A few innovative companies have successfully strengthened their relationships to their suppliers by adapting a program originally developed to better understand customers’ needs. Among Western businesses, it’s not uncommon for companies to invite their customers to critique them. They want to know, for instance, whether they are easy to do business with, or how well they are meeting their customers’ expectations. The formalized methodology they use for collecting customers’ comments and developing metrics for improvement is often referred to as a “voice of the customer” (VOC) program.

Similarly, some companies have a “voice of the supplier” (VOS) program that asks suppliers to measure the buyer’s performance. The program’s objective is to learn how well a buyer is meeting its suppliers’ requirements and to take the suppliers’ opinions into account when conducting business with them.

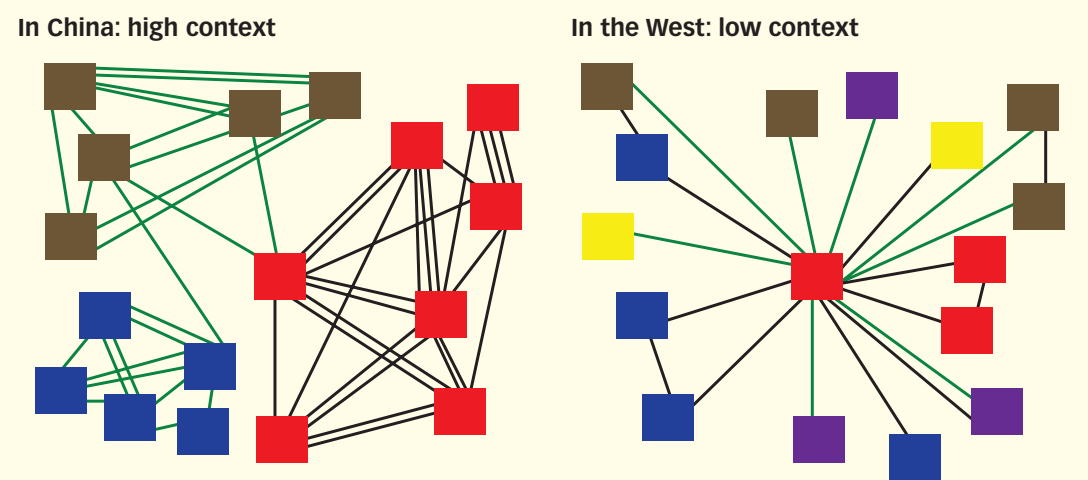
In our experience, it is rare for a Western firm to make the time

and effort to ask Chinese suppliers to evaluate their own performance and/or that of the buyers. But a few Western buyers are now trying to use the VOS approach to bridge the cultural and communications gap with their Chinese vendors. When buyers make this effort, they often are surprised by their findings. In one case that we know of, a U.S. company that was purchasing outdoor appliances from a Chinese supplier conducted a VOS exercise through an independent third party. Despite a seemingly close relationship spanning some 10 years, there were significant discrepancies between how the supplier viewed the buyer’s actions and how the buyer viewed them. (Figure 4 shows a simplified scorecard of some of the survey’s results.) By addressing these gaps, both companies were able to realize meaningful improvements.

As is the case with any such evaluation, buyers will need to develop appropriate metrics and determine what factors—both quantitative and qualitative—should be monitored. The appropriate frequency for measurement will depend on the individual circumstances and the degree of concern. Sometimes it will be monthly, other times quarterly or annually. Finally, cultural considerations come into play when implementing a VOS program with Chinese suppliers. As was true in the example just cited, it can be more effective to use an independent third party to obtain suppliers’ opinions.

The hierarchy of relationships has a great influence on the way Western buyers and Chinese suppliers work together.

[FIGURE 3] HIGH-CONTEXT VS. LOW-CONTEXT COMMUNICATION



▪ Less explicit communication	▪ People play by external rules
▪ More internalized understanding of what is communicated	▪ More knowledge is codified, public, external, and accessible
▪ Multiple intersections with others	▪ Separation—of time, of space, of activities, of relationships
▪ Long-term relationships	▪ More interpersonal connections of shorter duration
▪ Strong boundaries	
▪ Knowledge is situational, relational	▪ Knowledge is more often transferable
▪ Decisions and activities focus around personal, face-to-face relationships	▪ Task-centered

Because of the cultural prohibition against confrontation and direct criticism in business relationships, Chinese suppliers may be more open and honest with an independent party. It is well worth the effort: By identifying differences in perceptions, such as those shown in Figure 4, buyers will see where they can make improvements that could potentially lead to huge cost savings and significant improvements in efficiency. Given the major changes in the marketplace recently, it is important for companies to take the temperature of their supplier relationships to both uncover opportunities for improvement as well as flag potentially disruptive actions.



can offer the most competitive combination of:

- Costs and pricing;
- Speed to market;
- Security of supply;
- Intellectual property protection;
- Reasonable flexibility; and
- Longer-term stability.

Moreover, SRM can help buyers develop strong relationships with the right suppliers. A strong relationship means that buyer and supplier have achieved a level of intimacy and trust such that even sensitive information flows freely and securely between them. They share not just best practices but also the fruits and risks of their joint activities. Most significantly, supplier relationship management is the means for finding a reliable collaborator and friend with whom a buyer can navigate today's changing and increasingly complex global landscape. △

Providing a competitive advantage

While we have specifically discussed supplier relations in China because of its strategic importance to many companies' sourcing activities, the principles of supplier relationship management apply to sourcing in all geographies.

Effective supplier relationship management can yield many benefits and competitive advantages. A well-designed and well-managed supplier relationship

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[FIGURE 4] BUYERS' AND SUPPLIERS' DIFFERING VIEWS

Parameter	Supplier's View of Buyer	Buyer's View of Itself	Remarks/Explanation
	Rating	Rating	
Forecast/planning	1-2	7	Buyer's forecast/plan are dependent on information from customers Supplier's most problematic area
Design input/support	1	8	Does not involve supplier who has ideas to help
Engineering support	8-9	5	Buyer could enhance supplier performance with more attention
Manufacturing process know-how	1-2	9	Buyer does not share process knowledge—hurts performance
Component sourcing	9-10	5	Qualification process of vendors is too slow
Quality control instruction	8-9	8	In sync
Communication	3-4	7	Many areas of complaint by supplier

Scale: From 1 (poor) to 10 (excellent)