



ASIA PERSPECTIVE

Asia Perspective Outlook: Sourcing Survey 2021

When the Chain Breaks

Sourcing Trends in a Post-Pandemic World:
Regions, Channels and Organizations

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About Us



Asia Perspective is an independent management consultancy group with global presence and local knowledge. We assist our clients with strategic advisory and implementation, ongoing business services and venture investments. Our mission is to turn our clients' Asia business vision into reality and add significant value to their business.

Contact Details

Room 605, Bund Center
No.222 East Yan'an Road,
Huangpu District, Shanghai 200002, China
+86 (0)21 3401 0610
shinfo@asiaperspective.net
www.asiaperspective.net

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Executive Summary

Asia Perspective has conducted sourcing surveys regularly since 2013, aiming to measure the perception of China as a sourcing market, and how this perception is changing over time. The research is based on a survey sent to over 1,000 executives and purchasing managers in 11 countries around the world, thus reflecting changing opinions and paradigms rather than measurable sourcing changes, on which there already is sufficient data. The reason behind this form is to offer a glance into the future by measuring the intangible changes in perception that often predate tangible pattern shifts.

In 2021, companies have continued to face major supply chain disruptions. Global supply chains have been severely affected by movement restrictions and production shutdowns, which ultimately has a negative impact on companies' business. It remains unclear when the pandemic will be over, but it is obvious that companies need to take action immediately to mitigate the risks to their supply chain. The study reflects how the disruptions affect the perception of sourcing markets in Asia and offers hints on how they will impact global supply chains in the future.

The Study at a Glance:

- What is the current sourcing situation in China and in other parts of Asia?
 - What will sourcing look like post-pandemic and are there any long-lasting effects stemming from the pandemic?
 - What are the biggest perceived risks in the context of the world emerging from the pandemic?
 - What are the perceived risks with sourcing in China today (2021) compared to 2020?
 - Are there any sourcing trends that companies can capitalize on?
 - Which will be the most important sourcing countries and regions in the future?
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As the study shows, it is highly recommended that companies prepare thorough plans and strategies to react in a timely way to uncertain and unexpected changes and risks in their supply chain.

The study concluded that impacts of supply chain disruptions, mainly caused by COVID-19, are still causing a lot of difficulties for sourcing operations globally. In the long run, China continues to secure its position as the leading sourcing destination globally and will maintain its place in the foreseeable future. Moreover, the growing impact of COVID-19 on supply chains have exerted a significant influence on the perception of centralized supply chains and sourcing activities, which will continue to affect global trade in years to come. As the study shows, it is highly recommended that companies prepare thorough plans and strategies to react in a timely way to uncertain and unexpected changes and risks in their supply chain.

This year's study reveals insights into how companies have coped with the continuous disruptions in their supply chains, as well as the actions they plan to take to mitigate these going forward. For example, around 40% of surveyed companies see the need of expanding their Chinese supplier base with additional suppliers, in an attempt to prepare themselves for future business disruptions.

These approaches bring both challenges and benefits, and the key to successful decisions when shifting sourcing strategy lies in gathering the latest comprehensive data on a given market, evaluating the risks and business impact, as well as understanding the implications on a strategic level.

This year's study further concludes that companies' trust in China as a sourcing market remains strong. However, other alternative markets, especially Vietnam, continue to be an attractive option thanks to cheap labor, lower operational costs, growing capacity, and favorable trade conditions. Diversifying the sourcing locations is a must for companies aiming to reduce cost and mitigate risks caused by disruptions in supply chain.

Some specific findings of the report are:

- Respondents still see China as their main sourcing market, now and in the foreseeable future, and will keep sourcing in this country. However, more respondents than ever also indicate that they will relocate parts of their sourcing out of China within the coming years. Nevertheless, China still offers cost competitive production, with cost savings and production capacity still being the biggest reasons for companies to keep sourcing activities in China, while increasing cost is considered to be the highest concern. This is followed by unstable supplier performance and external factors.
 - The main reasons for companies to switch to alternative sourcing markets include cost saving, risk mitigation, and tariff avoidance. When entering a new market, companies are most concerned about the quality risk, insufficient knowledge of the market, and training costs for new suppliers.
 - Overall, this year's sourcing survey indicates two approaches to mitigating future sourcing risks similar to those we saw last year. The first approach is to stay in China and expand the supplier base, alternatively replace current suppliers with new ones. The second option is to completely or partially relocate the sourcing out of China, to one or several alternative sourcing markets. A difference we have seen this year is the increasing perceived importance of developing tighter communication with the Chinese suppliers to stay at the forefront of the latest supply chain updates.
 - As an alternative to China, Vietnam remains the strongest sourcing market in Southeast Asia. With its proximity to the technology-advanced South China and well-developed supply chain and logistical setups, Vietnam can offer low-cost opportunities for companies ready to relocate their sourcing presence.
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1 Introduction

The year of 2021 has continued to be a challenging year for global supply chains, primarily because the COVID-19 pandemic remains a global issue. Shipment delays, container shortages, increasing freight rates and raw material prices are a few examples of the issues we have witnessed. Moreover, other external factors, such as the Suez Canal Blockage, have unexpectedly disrupted international trade routes, causing delays for both companies and consumers. These incidents have undoubtedly caused major issues across several industries, and not only for China but also the world as a whole. Hence, these factors have shed light on the importance of diversifying supplier pools, to be able to tackle situations when one or several of your suppliers suddenly halt operations.

Although China swiftly responded to the outbreak and managed to contain its impact on the economy last year, its new outbreaks in key manufacturing cities and provinces recently are putting the economic recovery of China at stake. In this year's sourcing survey, Asia Perspective investigated how the supply chain disruptions, mainly caused by COVID-19, have affected the Chinese sourcing landscape, and if the perception towards the Chinese market has changed. Since the interest for Southeast Asia keeps on growing, this year's survey also puts more focus on the perception of this region as a sourcing destination.

As international competition and demands keep on growing, it is more crucial than ever for multinational companies to stay at the forefront of their global sourcing operations and strategy. To achieve this, companies need to keep their global sourcing strategy updated and effective, while constantly seeking new ways to reduce costs, assuring and improving the quality of their final products, as well as lowering the lead time to market.

Unsurprisingly, the study reveals that China has been, and will continue to be, the most important country for sourcing in the near future. However, the development of companies exploring alternative markets, such as Vietnam, are continuing to increase. Not only Vietnam, but Southeast Asia overall is considered a potential alternative market for sourcing. With lower costs of labor, operational costs and being less prone to import tariffs, the countries can offer lower production prices to the end customers. By diversifying your supplier pool, you can also hedge against problems caused by external factors, as COVID-19 has exemplified, making alternative markets not only an interesting alternative, but perhaps a must.

Now, companies have to analyze whether to shift from China to new sourcing markets, to develop and improve their current supplier base in the country, or doing both. The study reveals that improving communication with Chinese suppliers will be a key strategy going forward.

Global sourcing, defined as managing internal customer demand across business units and geographical markets, can be an overwhelming task. Not only in terms of managing cost, quality, and reliability, but also because of its role in driving top-line growth. Therefore, the purchasing function is rising in importance in global organizations, especially as other value-adding activities are being outsourced. In the meantime, factors such as rising commodity prices, supply reliability, and geopolitical concerns, are considered to be the largest risks that sourcing professionals face as supply chains stretch and change.



Daniel Karlsson
Managing Director, Asia Perspective

2 Methodology

The survey was conducted by Asia Perspective in June 2021. The data was collected through an online questionnaire consisting of 31 questions, covering the following topics:

- Sourcing markets overview
- Major sourcing problems and disruptions in 2021
- Managing risks associated to supply chain disruptions
- Perceptions on importance of different sourcing regions in the future

The majority of the survey participants are from the Nordic and Asian region, and are operational in the manufacturing, retail, machinery or automotive industry. Over 37% of the surveyed companies have a total global purchasing value of over 100 million EUR per year.

Figure 1
Survey Participants by Location

The geographical locations of the surveyed firms

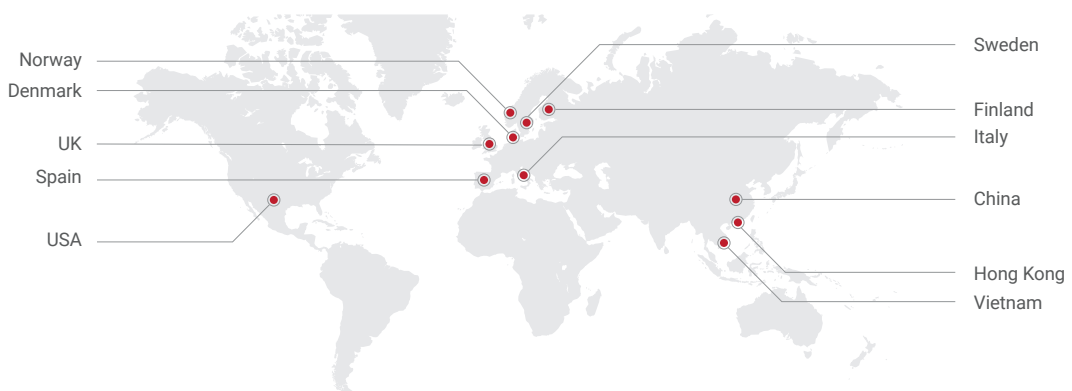
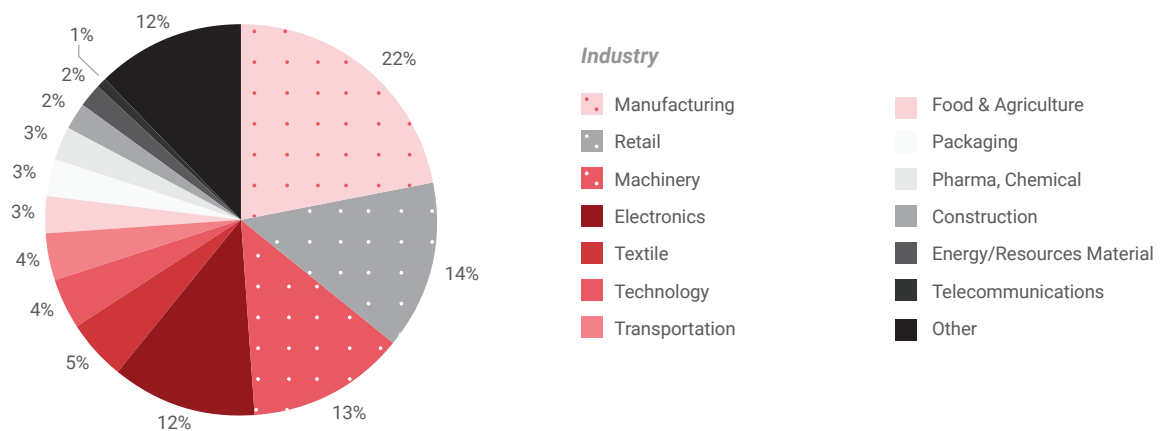


Figure 2
Survey Participants by Industry

Share of the respondents belonging to different industries



3 Sourcing Markets Overview

Over the past year, the whole world has faced major supply chain disruptions, mainly caused by the unprecedented COVID-19 pandemic. Sourcing activities in many countries have encountered a lot of disruptions caused by the repeated outbreaks. These issues, and their impacts, have pushed many companies to start to accelerate the diversification of their sourcing base to mitigate risks. This situation has provoked questions about how companies perceive sourcing activities in major sourcing markets such as China and Southeast Asia, and what major trends have emerged.

Sourcing activities in many countries have encountered a lot of disruptions caused by the repeated outbreaks.

This chapter illustrates our respondents' current sourcing situation in China and Southeast Asia. For the Chinese market, respondents' perception on sourcing value, sourcing purpose, and perceived risks are compared with the results of previous studies to identify trends and shifts of sourcing in China.

For the Southeast Asian markets, respondents' perception on sourcing value, sourcing purpose, and perceived risks were also measured to provide an overview of how this market is growing in parallel with China.

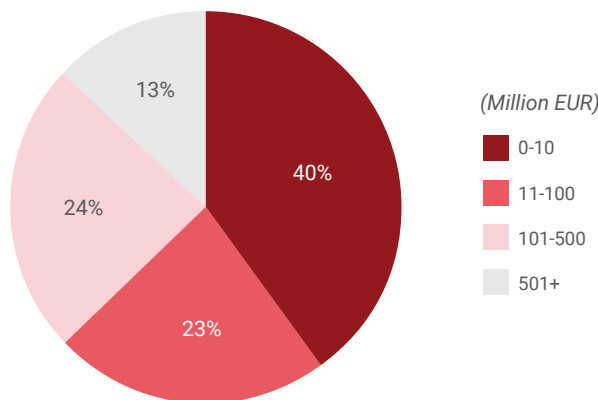
Moreover, since climate change is a growing concern, assessment of carbon footprint from sourcing activities was also included in the survey to provide a better understanding of how companies are handling this problem.

Figure 3 below provides the nearest estimations of the global purchasing spend from our respondents.

Figure 3

Total Global Purchasing Amount in 2020

Share of the respondents' companies belonging to different classes of total global purchasing amounts in 2020

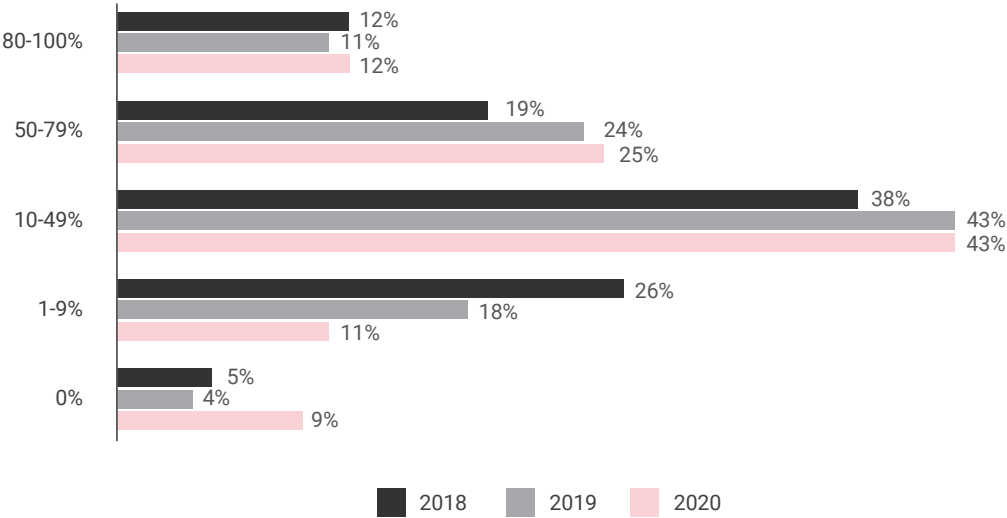


3.1 Current Sourcing Situation in China

The global sourcing trend remains unchanged from previous years as 88% of the respondents are currently sourcing from China. Despite several unfavorable conditions, including the ongoing trade disagreements between the United States and China, the trade tension between the European Union and China, and the supply chain disruptions caused by the COVID-19 pandemic, China is still an irreplaceable sourcing hub to the majority of surveyed companies. In addition to unparalleled advantages such as plentiful and skillful labor and a well-developed business ecosystem, the success of China’s government in putting the pandemic under control and facilitating economic recovery in the second half of 2020 also gives investors more confidence in maintaining their sourcing activities in China.

Not only do surveyed companies keep their sourcing activities in China, but their spending on this market remains unchanged as well. Like previous years, the majority of respondents source between 10% and 49% of their total global spend in China, exhibited in Figure 4. Moreover, the number of companies that spend more than 50% of their global purchasing spend on China account for 37% of the total surveyed companies. These numbers have clearly shown the strong reliance of companies on sourcing activities in China. Thus, China remains the top destination when it comes to sourcing in the foreseeable future.

Figure 4
Share of Purchasing Amount in China of Global Purchasing Spend in 2020
Estimation of how large the purchases amount was in China compared to the global purchasing spend in 2020

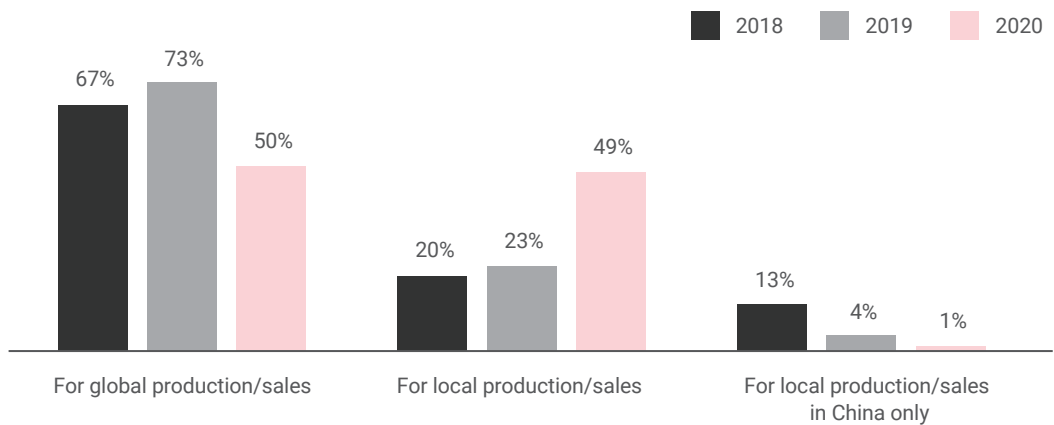


In general, the survey's respondents still consider China as a sourcing market mainly for global supply. 50% of surveyed companies shared that their ultimate purpose of sourcing in China is to serve their global production/sales activities, while 49% of the respondents stated that they source in China for both local and global production/sales. Only 1% of the respondents sources in China solely for local sales, a decrease for the second consecutive year. For many industries and sectors, China is the top destination for sourcing and is unlikely to be replaced any time soon due to its extraordinary production capability and capacity.

Figure 5

Reason for Sourcing in China – To Serve Local Demand or for Global Supply

Share of the respondents choosing the alternative as their main reason for sourcing in China



3.2 Risk Factors of Sourcing in China

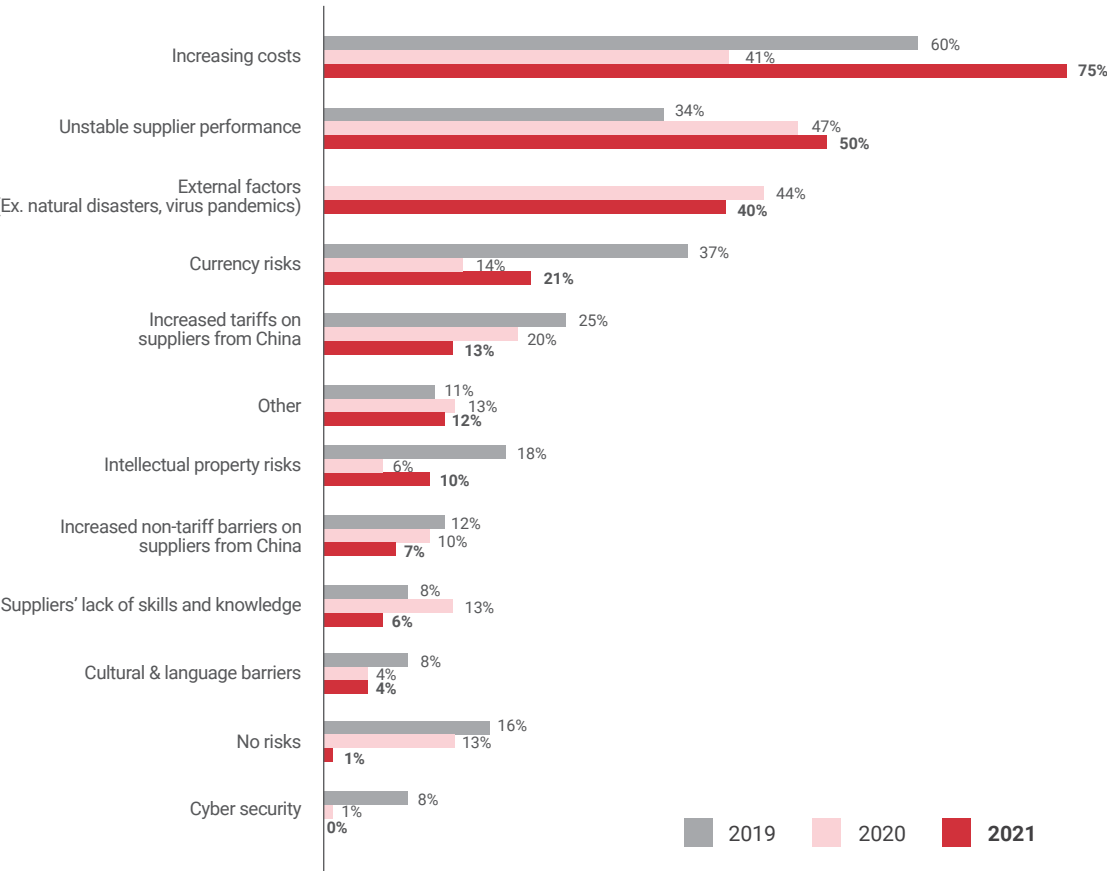
Despite the strong economic recovery of China in the past year, repeated COVID-19 outbreaks are posing huge disruption risks to the country's supply chain. To understand more about the biggest concerns of companies sourcing in China, and how they have changed over the past year, the surveyed participants were asked to select their three biggest perceived risks with sourcing in China 2021 compared to the previous year.

The difficulty that most of respondents (75%) faced in 2021 when sourcing in China is the increasing cost, fueled mostly by increasing raw material prices and soaring ocean freight rates. As a result of the surge in raw material prices, many small and medium-sized manufacturing companies have to reject new orders and temporarily shut down their production. In addition, the COVID-19 outbreaks in key manufacturing cities have also led to the second and the third most common perceived risk of sourcing in China: unstable supplier performance and external factors affecting production. Specifically, 50% of respondents claim that they have suffered from unstable performance of suppliers. At the same time, 40% of surveyed companies share that their orders were affected by external factors.

Figure 6

China Sourcing Risk Factors of Most Concern Compared to 2020

Share of respondents listing the category as one of their perceived top 3 risk factors



Increasing cost

Increasing cost is perceived as the biggest concern when sourcing in China with 75% of surveyed companies selecting it among top three risk factors, up by 34% points compared to 2020. This factor was driven mostly by the surge in raw material prices and rising transportation costs. China’s regulators have pledged to strengthen the market conditions and crack down on irregularities in order to stabilize the commodity prices in the second half of 2021. Many small and medium-sized companies had to reject new orders and temporarily shut down their production as rising input costs are making it impossible to turn a profit for their businesses.

Unstable supplier performance

Unstable supplier performance continues to be a growing risk when sourcing in China as expressed by 50% of the survey participants. It’s noticeable from the chart that 2021 has been the third consecutive year that this risk receives growing concern from companies. Performance of Chinese suppliers has become more and more unstable mainly due to disruptions caused by repeated outbreaks of COVID-19, but also due to environmental, administrative, and logistics challenges in China. Because of the outbreaks, many factories were forced to temporarily shut down, leading to delays and cancellations.

External factors

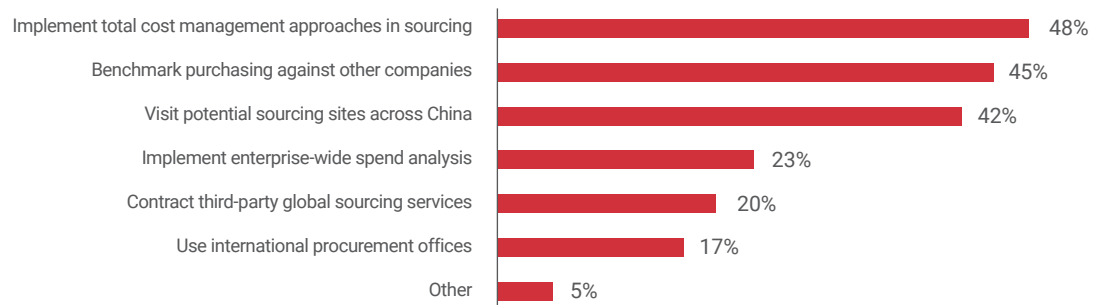
Ever since the pandemic, external factors has become much more of a threat to companies due to the unprecedented impact it has on global supply chains. External factors remains one of the top three concerns when sourcing in China in 2021 with 40% of surveyed companies expressing their worries over this risk. This comes as no surprise as the COVID-19 outbreak, an external factor, has caused a lot of negative impacts on supply chain of companies over the past year.

The data presented in Figure 6 clearly shows that there has been a shift in the matters of concern over the course of three years from 2019 to 2021. Supply chain disruptions caused by the pandemic have made surveyed companies much less concerned about currency risks, intellectual property risks, and cyber security. In the meantime, tariff and other trade barriers imposed on Chinese suppliers due to trade tensions have started to become a growing concern among respondents.

Figure 7

Sourcing Improvement Strategies

Share of respondents listing actions they have taken to improve sourcing in China in 2021



When being asked about actions taken to improve sourcing activities in 2021, 48% of surveyed companies shared that they have implemented total cost management approaches to keep their spending on sourcing under control, making it the most adopted tactic among the respondents. Benchmarking purchasing against other companies to evaluate efficiency and make timely adjustment is the second most adopted action to improve the sourcing situation, followed by visiting potential sourcing sites across China to look for cost-saving solutions (selected by 42% of survey participants).

3.3 Carbon Footprint Assessment of Chinese Suppliers

In recent years, a great number of countries across the globe have expressed their growing interest in climate actions and have come up with several action plans to monitor their impacts on the Earth. Specifically, 'Striving toward a climate-neutral EU' has been a common goal across Europe for a long time and was legalized into the European climate law in 2020. The ultimate goal of this law is to reduce the greenhouse gas net emission of the EU by at least 55% by 2030 compared to 1990.

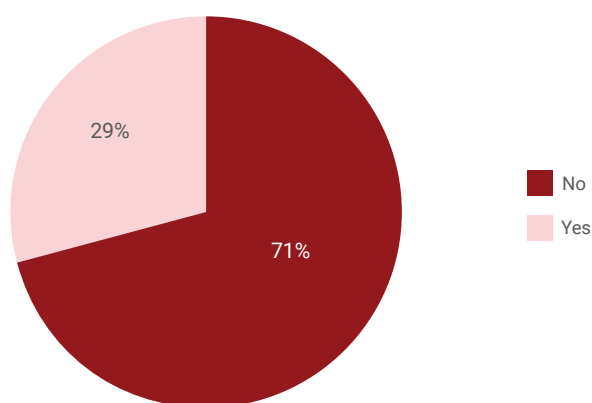
It is obvious that the European Union is taking the climate change issue seriously and prioritizing it on the regional level. It is a similar situation in the U.S., as the country's leadership has expressed its ambition in tackling domestic and global climate issues and driving the U.S. to reach net zero emissions no later than 2050.

To get a better understanding of companies' engagement on this matter, we asked the respondents about how they are assessing the carbon footprint of their Chinese suppliers.

Figure 8

Assessment of New Potential Chinese Suppliers' Carbon Footprint

Respondents share whether they assess carbon footprint of new potential Chinese suppliers



According to the survey's result, 71% of respondents said that they do not collect carbon footprint of new suppliers when assessing them. In addition, carbon footprint data collection is still quite limited and unpopular among Chinese suppliers as 70% of surveyed companies shared that, based on their experience, suppliers usually do not know about their own carbon footprint and cannot provide the information if requested by their customers.

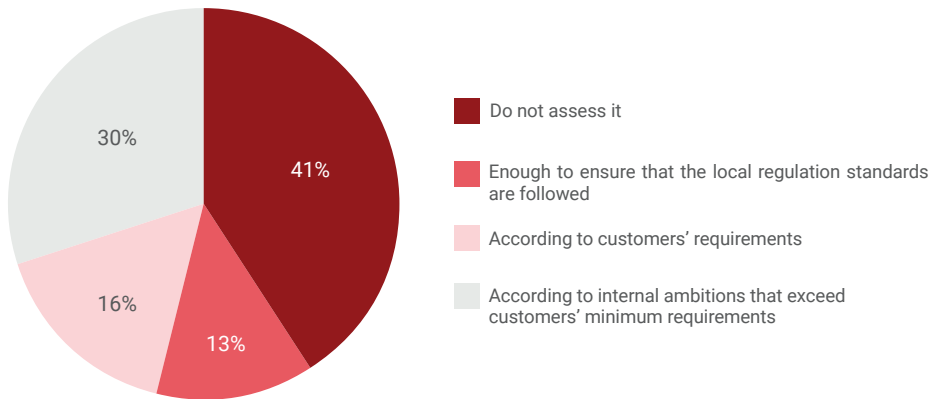
Figure 9 below demonstrates the current carbon footprint assessment situation of surveyed companies. Overall, 59% of surveyed companies are assessing the carbon footprint of their suppliers to some extent, from the minimum level of assessment to extra efforts in controlling the suppliers carbon footprint. From the chart, it is also noticeable that while 41% of respondents do not assess the carbon footprint of their suppliers at all, 30% of surveyed companies are going the extra mile by assessing suppliers' carbon footprint based on their own goals that exceed their customers' minimum requirements.

With many climate actions coming into effect, such as the European Union's climate and energy framework and the U.S.' 2050 emissions target, carbon footprint of companies, especially in the manufacturing industry, will be more closely monitored in the near future. To avoid any disruption caused by disobedience of the newly initiated regulations, companies are advised to start including carbon footprint assessment in their operations.

Figure 9

Assessment of Current Chinese Suppliers' Carbon Footprint

Respondents share the extent to which they assess carbon footprint of Chinese suppliers



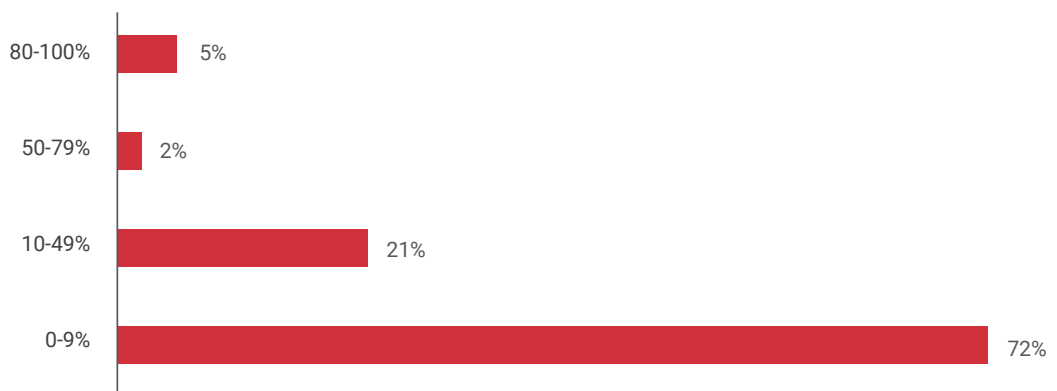
3.4 Current Sourcing Situation in Southeast Asia

Many companies started their sourcing activities in Southeast Asia a long time before the pandemic, mainly due to cost saving reasons and continuously improved production capabilities, developing logistics, and many other favorable trade conditions that this region has to offer. Now, with the outbreak of COVID-19, diversifying sourcing locations has become more and more important to international corporations. Therefore, starting from 2021, Asia Perspective has decided to investigate more into sourcing activities of surveyed companies in Southeast Asia in order to understand their perception of this market and evaluate the importance of Southeast Asia to their businesses.

Figure 10

Share of Purchasing Amount in Southeast Asia of Global Purchasing Spend in 2021

Estimation of how large the purchase amount was in Southeast Asia compared to the global purchasing spend in 2021



In general, Southeast Asian markets are of great interest to surveyed companies with 65% of them having sourcing activities in this region. However, the purchasing value of surveyed companies in Southeast Asia is still significantly lower than that in China. More specifically, the majority of respondents spend less than 9% of their global spending on sourcing in Southeast Asia. Companies whose sourcing spending is more than 50% account for only 7% of the total companies sourcing in Southeast Asia. Among the Southeast Asian countries, Vietnam emerges as the top destination for sourcing thanks to low-cost labor, well-established supplier bases and favorable free trade agreements with major trade partners. 73% of companies who are sourcing in Southeast Asia named Vietnam as an important sourcing location, followed by Thailand and Malaysia with the most competitive import-export procedures and infrastructure in the region.

Figure 11
Sourcing Locations in Southeast Asia

Respondents' current sourcing locations in Southeast Asia

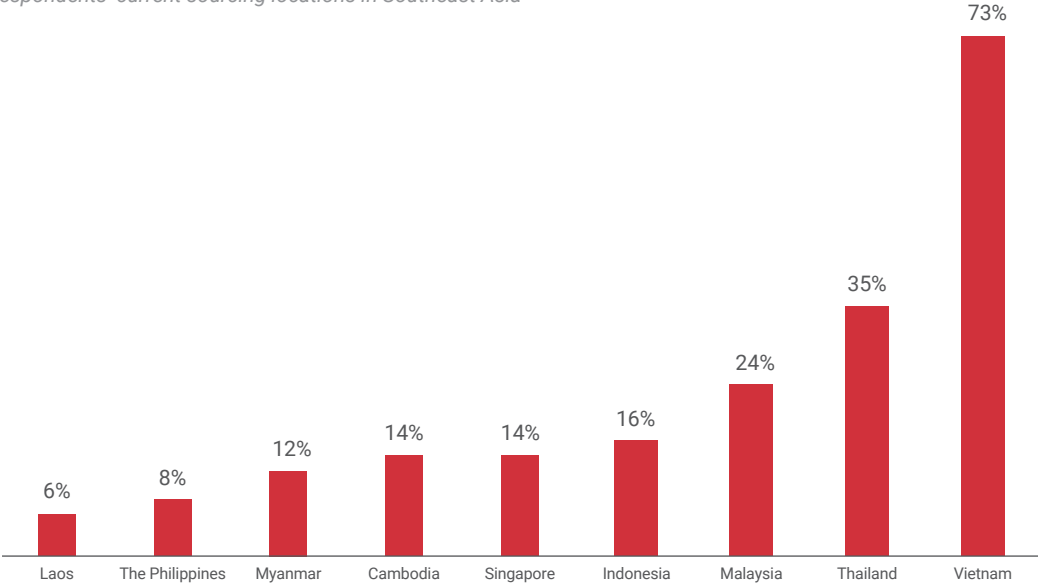
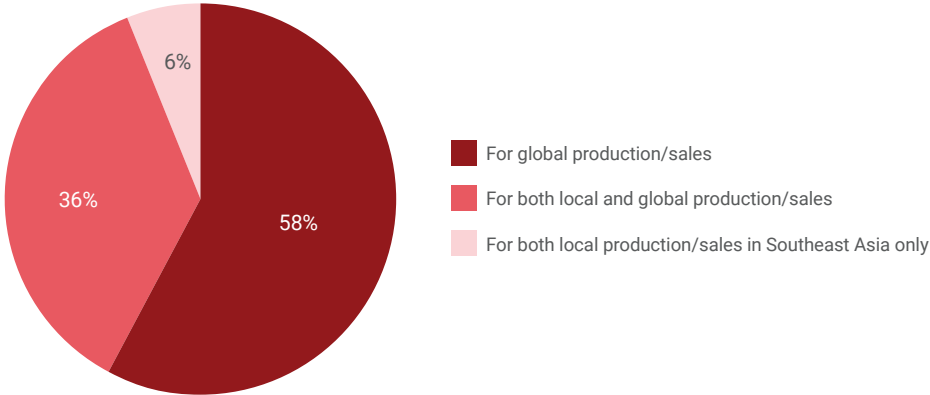


Figure 12
Reason for Sourcing in Southeast Asia – To Serve Local Demand or for Global Supply

Share of the respondents choosing the alternative as their main reason for sourcing in Southeast Asia

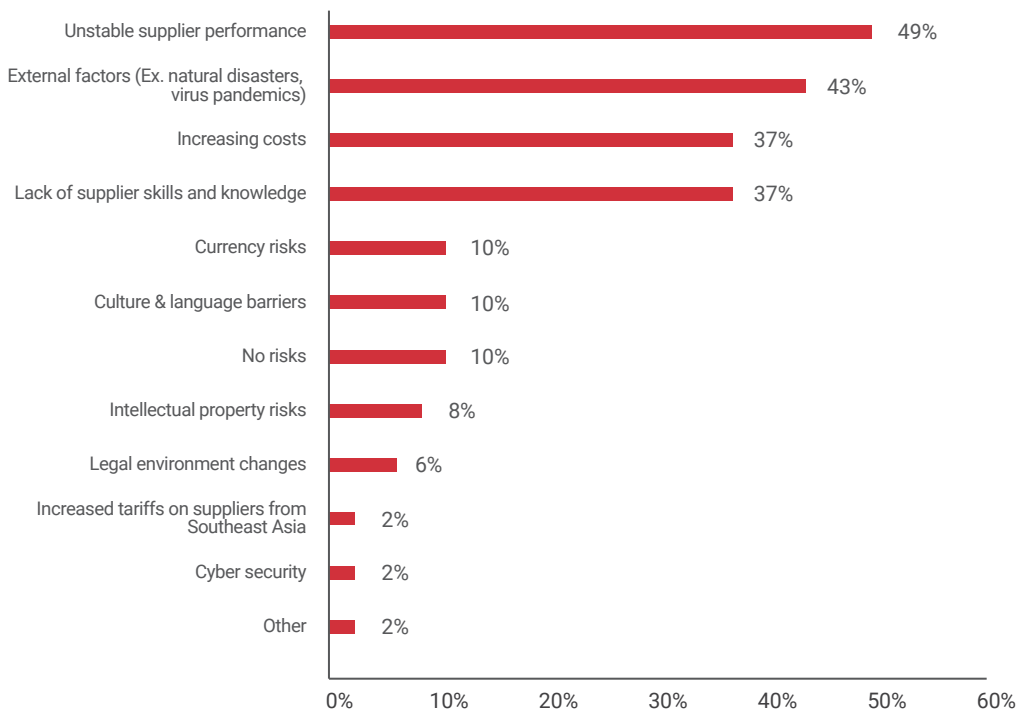


Similar to the situation in China, surveyed companies also consider Southeast Asia an alternative sourcing hub to serve their global production and sales activities. In addition, respondents share the same top three perceived risks when sourcing in Southeast Asia as in China: unstable supplier performance, external factors, and increasing costs. However, as production activities keep getting affected by continuous outbreaks in Southeast Asia, companies are most concerned about the unstable performance of suppliers. A third and fourth wave of COVID-19 is hitting hard in several countries in Southeast Asia, and has forced many factories to temporarily cease their production. Moreover, the domestic transportation of goods and materials is also disrupted due to travel restrictions and lockdowns, causing serious delays in order shipments. The emergence of new variants of the coronavirus has made it significantly harder for governments to keep outbreaks under control. Companies fear that with the current pandemic situation going on, sourcing activities from Southeast Asia will be heavily affected.

Figure 13

Southeast Asia Sourcing Risk Factors of Most Concern in 2021

Share of respondents listing the categories as their perceived top three risk factors



4 Challenges for Sourcing Activities

By now, we know that the pandemic is causing major issues globally. However, other external factors, such as the Suez Canal Blockage has also caused major challenges for global companies. This probes the questions on how prepared companies are battle future disruptons, and what their strategies to cope with this uncertain times are.

This chapter aims to answer three questions:

- What are the biggest sourcing problems and supply chain disruptions companies encountered in 2021?
- How prepared are companies in handling supply chain disruptions?
- What risk mitigating strategies are companies planning for their future sourcing activities?

4.1 Sourcing Problems

81% of respondents named increasing cost a main problem affecting their sourcing activities, followed by logistical disruptions and delays (75%) and longer lead time from suppliers (58%). The biggest issue, increasing cost, is driven mainly by the rising raw material prices and surging freight rates, while the prolonged lead-times and disruptions are a direct effect of production shutdowns.

Figure 14

Biggest Sourcing Problems Faced in 2021

Share of respondents listing top three sourcing problems they have encountered in 2021

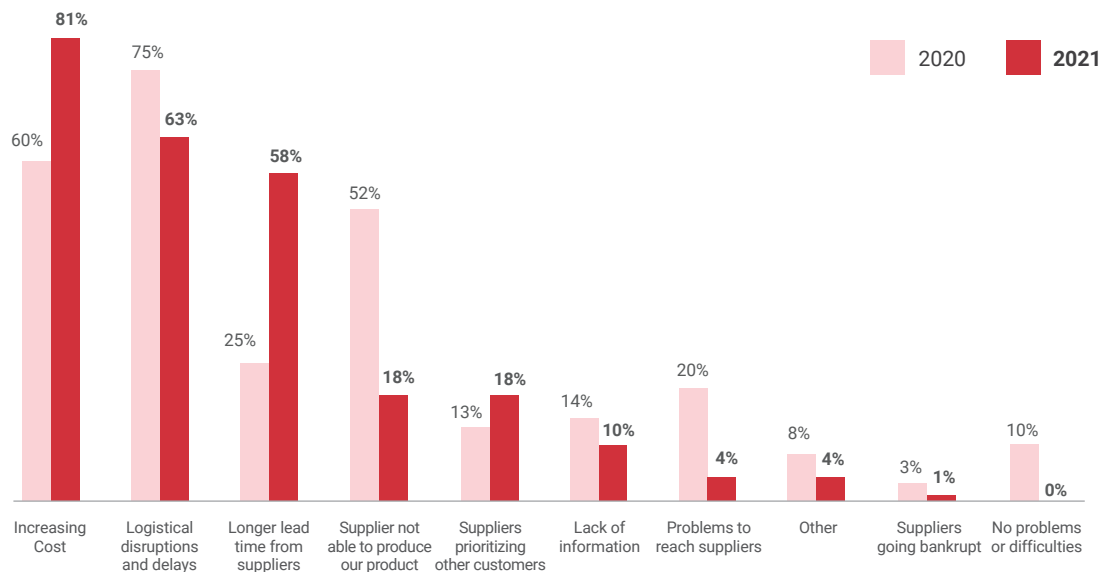
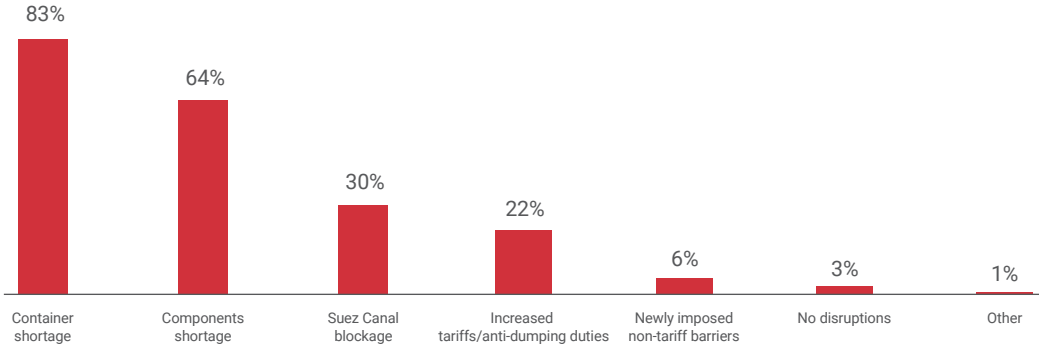


Figure 15 below clearly indicates that a container shortage has, by far, been the most common sourcing issue surveyed companies have had to cope with during 2021. The pandemic has affected the global flow of imported and exported goods negatively, leading to containers being stacked up in inland depots or at cargo ports instead of being sent to locations that need them. The second most common disruption, component shortage, was caused by the shutdown of factories in many countries as a result of restrictions as well as rising raw material prices, putting the suppliers' profitability at risk. The Suez Canal blockage that happened in the second quarter of 2021 was also a problem that most companies had to encounter since it severely affected many shipping routes, especially the ones from Asia to Europe. The blockage of this main transportation route caused shipment delays and rising transportation cost to many companies. For those who stuck with ocean freight, both the shipping time and freight rates increased considerably as the ships had to sail a longer route around the Cape of Good Hope at the southern tip of Africa instead of going through the man-made canal. Many companies were reported to switch their transportation to railway or airway to deal with this disruption.

Figure 15
Supply Chain Disruptions Faced in 2021

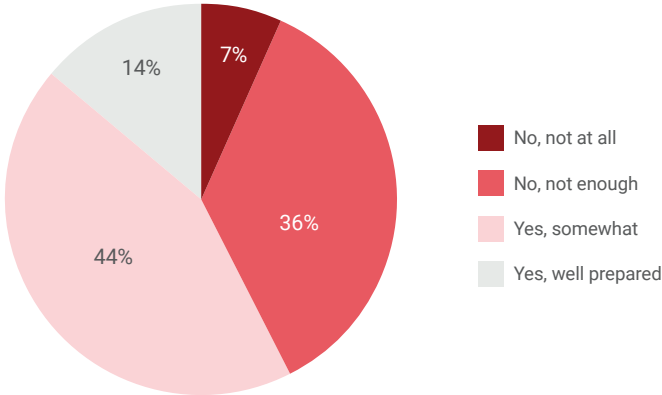
Share of respondents listing three supply chain disruptions they have encountered in 2021



4.2 Risk Mitigation Strategies

Figure 16
Surveyed Companies who were Prepared to Handle Supply Chain Disruptions

Share of respondents who believed their company were prepared to tackle the disruptions

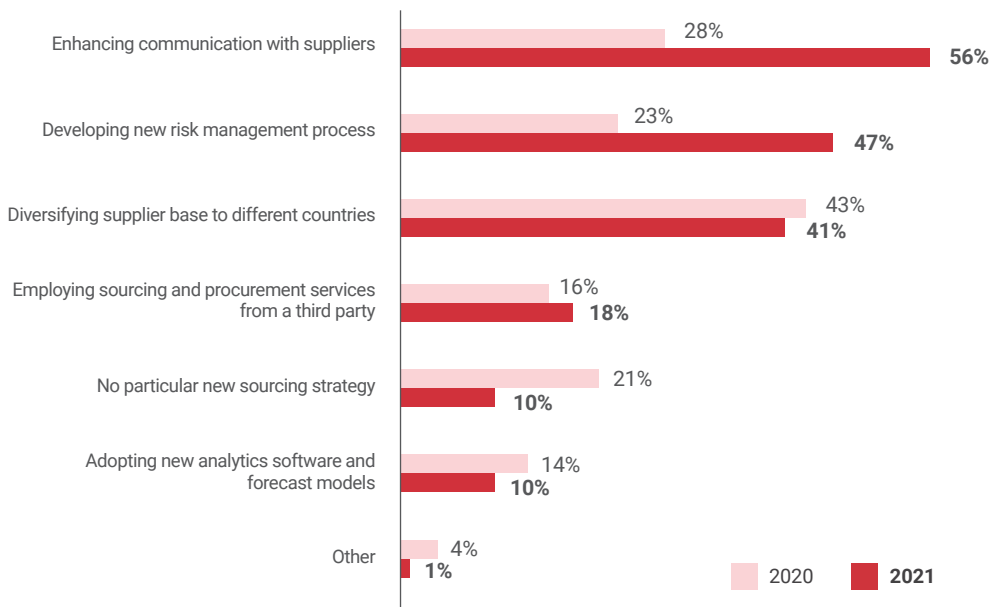


More than a third of the survey participants stated that their companies were not prepared enough to handle the supply chain disruptions in the past year. As the data doesn't indicate any specific correlation between an industry and its preparedness, this shows that the lack of risk management and mitigation strategies is a widespread issue throughout sectors and industries. To better understand companies' strategies in handling supply chain disruptions, all participants were asked to select up to three strategies that they see necessary in the future, as shown below in Figure 17.

Figure 17

Future Sourcing Risk Mitigating Strategies

Share of respondents listing sourcing risk mitigation strategies to reduce impacts of supply chain disruptions



In general, the survey indicates that there are three main approaches to mitigate future sourcing risks. The first option is to enhance communication with suppliers to reduce order-fulfilment-related problems to the lowest possible level. The percentage of respondents that chose to enhance communication with suppliers has doubled from 2020 to 2021, showing a significant increase in perceived importance of this strategy in mitigating sourcing risks. The second option, developing new risk management processes, also doubled from 23% to 47%. Without any doubt, risk management has become crucial to companies to deal with problems caused by the current turbulent situation. The third option is to diversify the supplier base to different countries. Since the pandemic has affected countries differently, buying from more than one country is a necessary move to mitigate the disruption in supply chains for companies. Moreover, setting the pandemic factors aside, diversifying sourcing locations can help companies take advantages of different trade conditions as well as regional specializations, which is extremely beneficial in the long run. It is also noticeable from Figure 17 that surveyed companies are more active in coming up with risk mitigating strategies compared to 2020 as the percentage of respondents choosing no particular new sourcing strategy has dropped by half to 10%.

5 Future Sourcing

This year's study reveals that enhancing communications with suppliers is the number one tactic of surveyed companies in mitigating sourcing risks now and in the near future. Two other major risk mitigation strategies are still expanding the Chinese supplier base and partially or fully relocating to an alternative sourcing market.

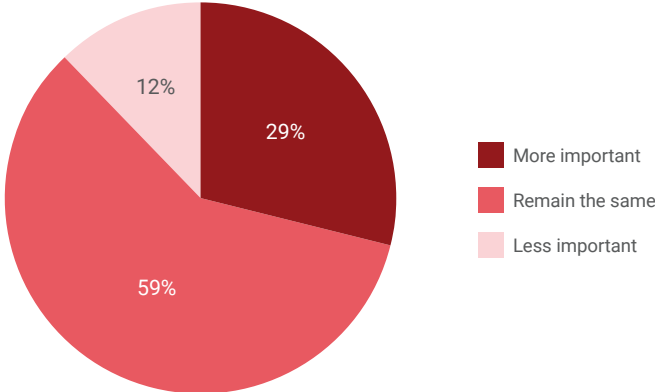
This chapter aims to answer three questions:

- What is the outlook on future sourcing in China, and what strategies do companies have to tackle supply chain disruptions in the long run?
- What is the outlook on alternative sourcing locations, and what are the biggest problems faced when relocating sourcing operations?
- What geographic areas and countries are perceived as the most important sourcing locations for the future?

5.1 Future Sourcing in China

Although alternative sourcing markets become more and more popular amongst international enterprises, 59% of the survey participants still believe that China will remain of the same importance as of today when going into the future. Despite growing disruptions in supply chain and the trade tension between China and many regions, companies' trust in China remains high, with the data even indicating that there is a bigger share expecting China's importance to grow further compared to the current level.

Figure 18
Expectation on China's Future Role as an Important Sourcing Market
Share of respondents' perception of China's future role as an important sourcing market

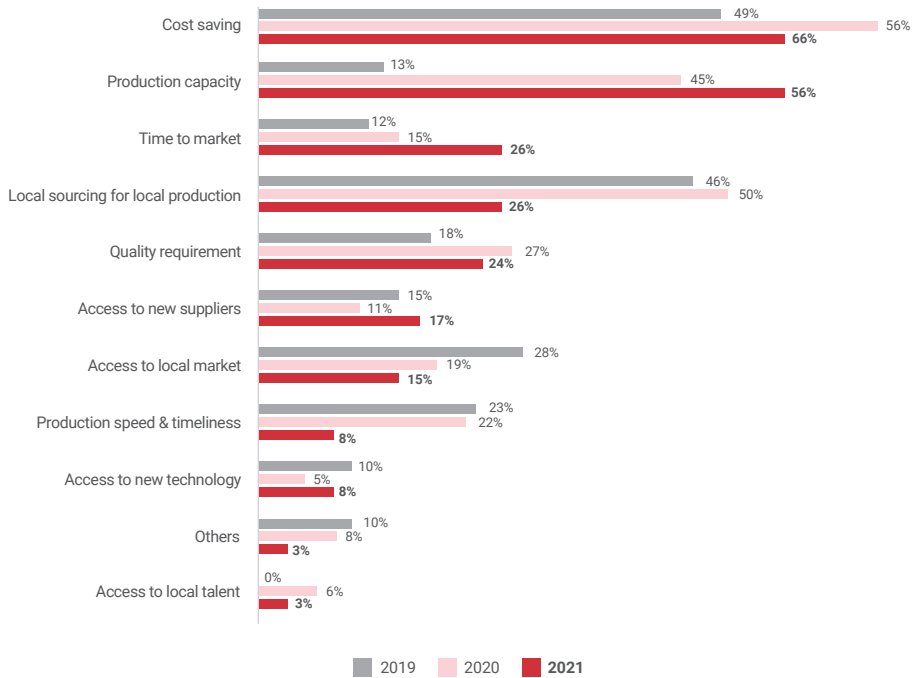


Respondents were also asked about the main reasons for continuing their sourcing activities in China. The result showed that the four main reasons include: cost saving, production capacity, time to market, and local sourcing for local production. From figure 19, it is noticeable that quality requirement has also gained more and more interest from surveyed companies over the years. The common perception towards the Chinese market is usually cost saving rather than quality, but this trend has proven that this perception has gradually changed. With product quality constantly improving along with production capacity and capability, it is likely that more and more companies will consider this factor a main reason for staying in China.

Figure 19

Reasons for Keeping Future Sourcing in China

Share of respondents listing top three reasons for keeping sourcing in China



Cost saving

As the largest sourcing hub in the world, China still maintains its competitive edge when it comes to cost saving. For the third consecutive year, cost saving emerges as the number one reason for companies to keep sourcing in China. The country’s well-developed supply chain as well as suppliers’ years of experience are the two main factors that keep China’s productivity high, and ultimately maintains China’s cost competitiveness.

Production capacity

China has always been well-known for its large production capacity that enables the country to manufacture and export products all over the world. Although China is also severely affected by disruptions in supply chain, Chinese suppliers still manage to maintain their production at the highest possible level. In the current context with frequent disruptions, production capacity has clearly become more and more important to companies. Only 13% of surveyed companies considered production capacity a reason to keep sourcing in China in 2019, but the number more than tripled to 45% in 2020, and then reached 56% in 2021.

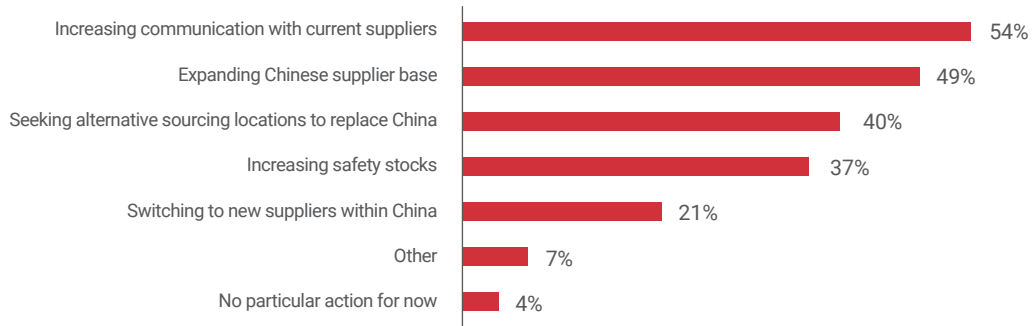
Local sourcing for local production & Time to market

Both local sourcing for local production and time to market were selected by 26% of survey participants as one of their main reasons for keeping sourcing in China. The improvements in manufacturing capability and quality, together with workforce competence in China over the last decade continue to be the key drivers of companies’ local sourcing activities for local production. With the acceleration in local production and sales of surveyed companies, time to market has also emerged as a key reason for them to maintain sourcing in China.

Figure 20

Long-Term Plan to Improve Sourcing Activities in China

Respondent's top three strategies to manage supply chain disruptions in the long run



As disruptions of various kinds will always be a part of the global supply chain it is crucial that companies can come up with actions to handle disruptions and keep the impact on their supply chain under control. Surveyed companies were asked to share their strategies for mitigating supply chain disruptions when continuing their sourcing in China. Similar to the risk mitigation strategies (figure 17), respondents focus mostly on enhancing communication with current suppliers. Companies believe that clear communication and good relationship with suppliers are of the most importance in helping them mitigate order fulfilment related problems. Respondents also think that diversifying their supplier base in both China and other markets is a necessary and inevitable move to overcome challenges caused by supply chain disruptions.

5.2 Future Sourcing in Alternative Markets

When measuring the likeliness of participants relocating parts of their sourcing out of China within the two coming years, it is noticeable that the proportion of companies saying that it is likely or very likely for them to do this has dramatically increased from 19% last year to 49% this year. This sudden change aligns with the current trend of expanding supplier base to different markets to mitigate supply chain disruptions, reduce costs, and minimize operational risks among many companies. Although China will remain the number one sourcing destination, the importance of other sourcing markets has also grown.

Figure 21

Likeliness to Completely or Partially Relocate Sourcing out of China

Share of respondents that will relocate their sourcing from China within 2 years

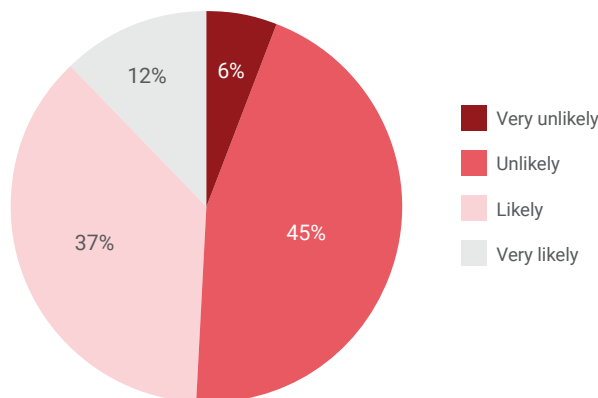
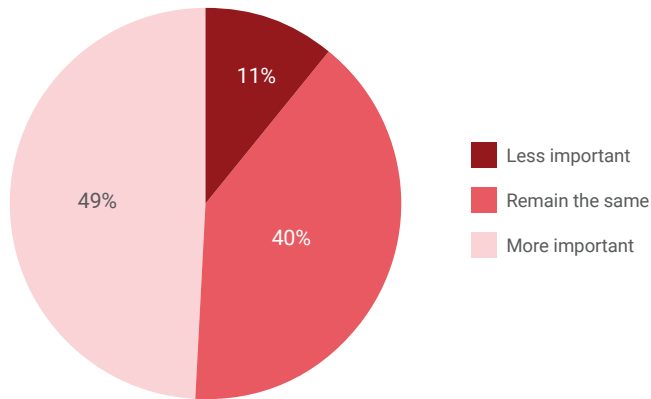


Figure 22

Expectation on Southeast Asia's Future Role as an Important Sourcing Market

Share of respondents' perception of Southeast Asia's future role as an important sourcing market

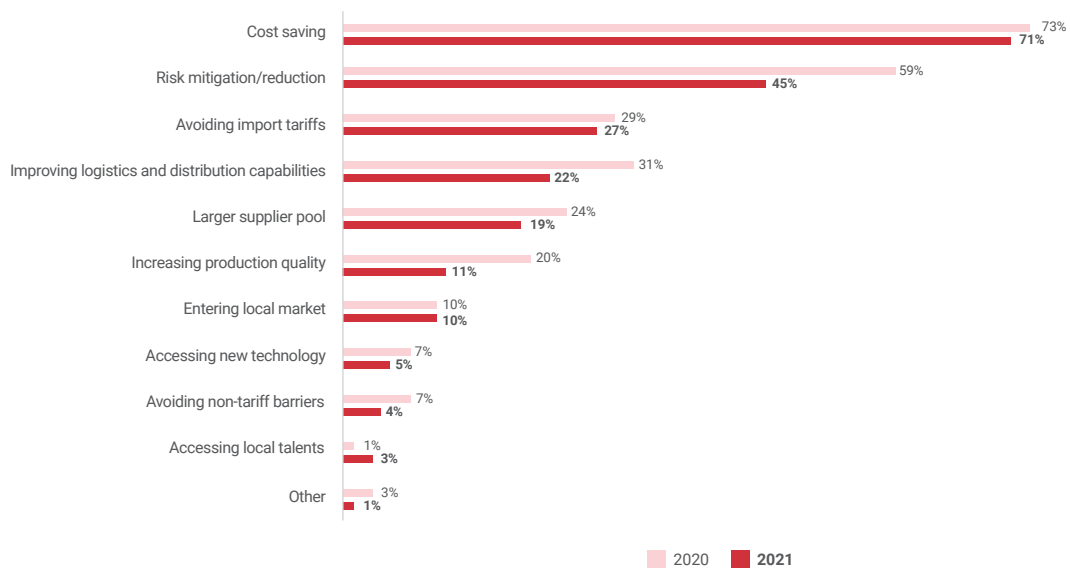


With the increase in sourcing activities in Southeast Asia, it comes as no surprise that nearly 50% of surveyed companies think that Southeast Asia will become a more important sourcing market in the future. To better understand what companies are looking for when switching to new sourcing markets, surveyed companies were asked to share their main reasons for making this relocating decision. Top three reasons include cost saving, risk mitigation, and import tariffs avoidance.

Figure 23

Reasons for Switching to a New Sourcing Market

Share of respondents listing top three reasons for switching to a new sourcing market



Cost saving

Cost saving is still the biggest perceived reason to relocate sourcing to an alternative market. Markets in Southeast Asia, such as Vietnam, Thailand, and Indonesia all offer cheaper labor and operational costs in comparison to China, but also bring new challenges. When relocating, companies need to assess more aspects than just production price to accurately calculate the total cost, such as the size and capabilities of the manufacturing base, legal requirements, and logistics capacity. For example, China's domestic and international logistics networks are far more developed than those of Southeast Asian countries, and thus often contribute to a lower total cost, shorter lead time, and less risk.

Risk mitigation

The second biggest perceived reason to complement with a new sourcing market is still risk mitigation with 45% of respondents naming this advantage. Diversifying the geographical footprint of sourcing activities may not be good in terms of economies of scale, but it is highly necessary in hedging against regional risks and external factors. By spreading the sourcing activities, a company's operation is not as dependent upon the status of one country, hedging against the risks of local supply chain disruptions.

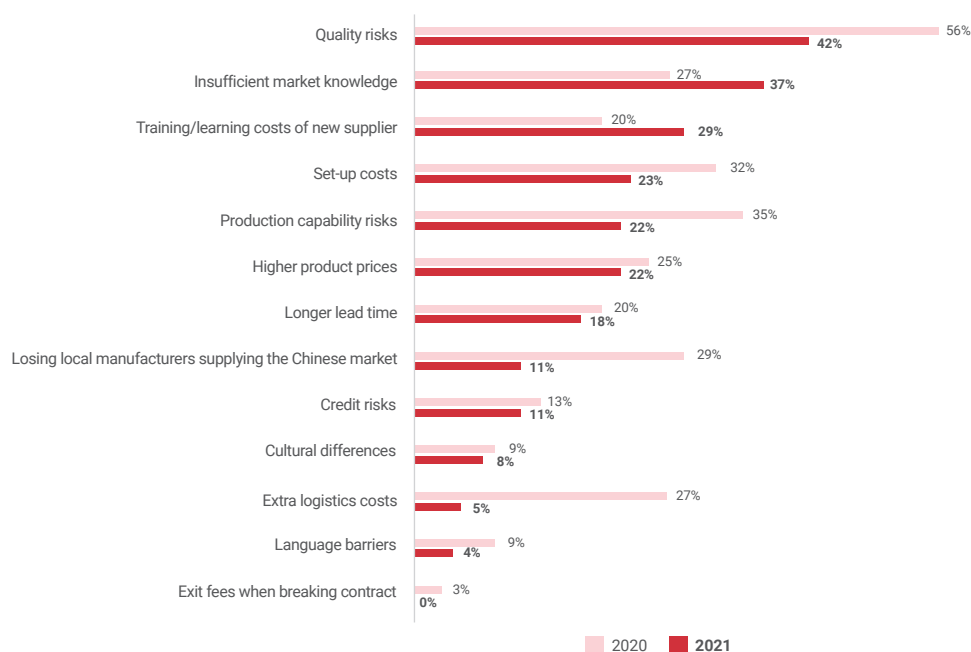
Avoiding import tariffs

In Southeast Asia, Vietnam has gained significant interest from foreign investors thanks to many free trade agreements and partnerships that the country successfully established over the past few years. Trade conditions among different countries and imposed tariffs are important factors to global supply chains as they make up a considerable cost. The trade tension between China and other countries has posed a huge threat of increasing tariffs on goods exported from China. Even without the free trade agreements, Southeast Asian countries are a good option to consider due to their normal trade relations with other countries as well as their relentless effort in establishing new trade partnerships.

Figure 24

Main Barriers to Consider when Entering a New Sourcing Market

Share of respondents' listed reasons of main barriers when relocating to a new sourcing market



Quality risks

Even though decreasing by 25% since last year, quality risks are still perceived to be the biggest barrier when entering a new market, with 42% of the survey participants naming it. The reason for the drastic decrease might be a result of the fact that more and more companies are investing, and starting sourcing operations in Southeast Asia, and thereby understanding that the quality requirements can be met in the region. However, entering a new market obviously brings uncertainties to the production, and thereby putting the quality at risk. To overcome this barrier, thorough research on the considered suppliers, including in-depth analyses, on-site visits, and sample testing are required to ensure that the required quality is achieved.

Insufficient market knowledge

Insufficient market knowledge has become a growing concern for surveyed companies as it jumped from 6th place last year to 2nd place this year. Insufficient knowledge about the market's strengths, weaknesses, supply chain, and so on may potentially cause a lot of disruptions to the operations of companies when entering a new market. Therefore, companies need to do thorough research about targeted industry in targeted markets to get a holistic view of the markets and be able to make well-informed decisions about market entry.

Training cost of new suppliers

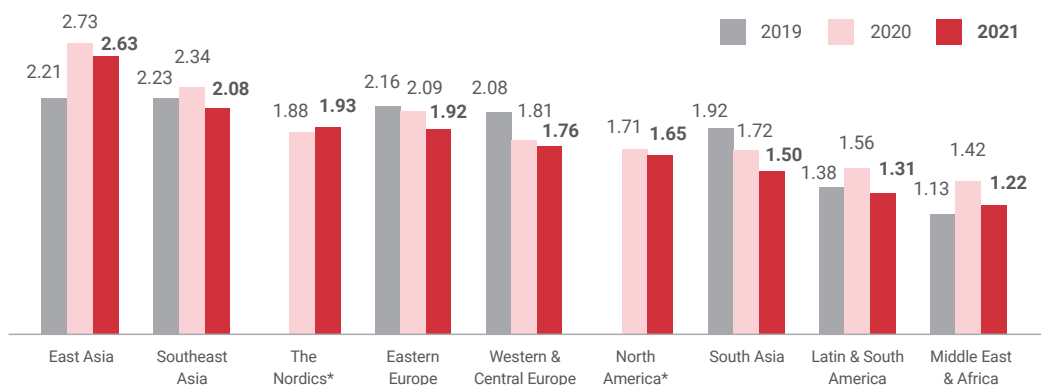
As the third biggest barrier, 29% of the participants named training cost of new suppliers. It is common that suppliers in other markets may not be as experienced as Chinese suppliers. Therefore, when first working with them, it may take quite a lot of time as well as cost to familiarize them with the company's working process and product quality. To reduce this cost to the lowest possible level, companies should conduct a comprehensive supplier search and evaluation before entering a new market. The research and evaluation will help companies identify the most experienced and suitable suppliers who require less resources to be invested in.

5.3 Perception on Sourcing Locations in the Future

Figure 25

Perceived Importance of Geographic Areas for Future Sourcing

Respondents rate the importance of different geographic areas for future sourcing from 1 to 3

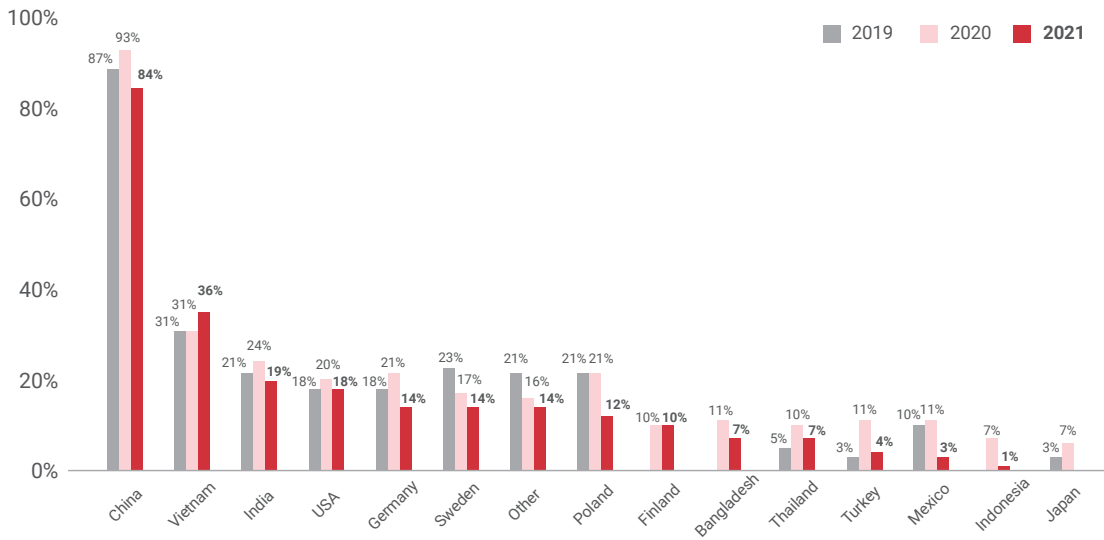


*The Nordics and North America were not measured in 2019's survey

In general, the perceived importance of areas for future sourcing has barely changed over the last three years. East Asia and Southeast Asia continue to be the two most important regions for sourcing for the third consecutive year. For the reasons discussed in the previous parts of this report, these two regions are expected to remain their importance in the foreseeable future. Other European regions including the Nordics, Eastern Europe, Western & Central Europe remain in top five thanks to their deep understanding of the European market, and high-quality labor. The Middle East and Africa are still considered undeveloped sourcing markets without known competitive edges and are thus perceived as the least attractive among surveyed regions.

Figure 26
Perceived Importance of Sourcing Locations in the Future

Respondents shared the three most important sourcing countries to their company in the future



Overall, the top three countries for sourcing stay the same as last year. China is clearly still recognized as the most important sourcing country in the near future. For the third consecutive year, Vietnam holds the second place, with 36% of the participants naming it one of their three most important countries for sourcing. India continues to stay at the third place despite supply chain disruptions caused by a severe pandemic outbreak in Q2 2021.

Suppliers in Central Europe can expect more sourcing activities in the future. A well-developed infrastructure and geographical proximity to Western Europe provide opportunities that other sourcing regions do not have. Most importantly, as most of Eastern Europe is immune to trade disputes and tariffs against other European partners, and the EU-legal system with common standards make sourcing there somewhat easier.

6 Conclusions

This year's study once again reveals that China will continue to be the number one sourcing location to the majority of surveyed companies in the foreseeable future. Despite unfavorable supply chain disruptions caused by increasing transportation cost, material cost and availability, container shortage; and worsened trade conditions caused by tensions between China and other countries, companies still decide to keep a large part of their sourcing in China. This decision is mostly fueled by China's unparalleled advantages, including cost efficiency, production capacity, quality, and short time to market.

The study also shows that the perceived importance of China as a sourcing market remains the highest. The main reason for this has been China's way of coping with the pandemic, which enabled the country to maintain manufacturing and logistics activities at a high level. Besides, companies are also aware of how challenging it is to find an alternative sourcing market to replace China. Despite the advantages of Chinese suppliers, companies sourcing in China still express several concerns relating to increasing cost, unstable supplier performances, and turbulent external factors that threaten companies' supply chains. To overcome these challenges, most surveyed companies follow two directions: working more closely with their current suppliers or diversifying their options both in China and to other regions.

In parallel with the development of the Chinese sourcing market, the Southeast Asian market has also gained much interest from foreign companies thanks to the region's fast-growing production capacity and favorable trade conditions. The perceived importance of Southeast Asia as a sourcing location is expected to grow further in upcoming years. Vietnam is currently the most popular sourcing country in the Southeast Asian region. Although these markets show potential, surveyed companies still express certain concerns about quality risk, market knowledge, and large expenses for training new suppliers when deciding to switch sourcing market.

Over the last year, companies continued to encounter many sourcing problems globally, including increasing costs, logistical disruptions and delays, and longer lead times. The supply chain related disruptions have made these problems become more severe to multinational sourcing activities with increasing cost being the most common problem that companies encounter. The increasing cost is mainly driven by the surge in raw material cost and transportation cost, which makes companies struggle to maintain their margins. It is especially noteworthy that the ocean freight rates have witnessed a record breaking increase over the past year. According to many experts, the surge in freight rates has not yet reached its peak and is not likely to go down any time soon, indicating that the increasing costs will continue to be a major problem that companies must face. Besides, longer lead times is considered a growing problem as there was a double growth in number of companies encountering this problem. Prolonged lead time is mainly caused by disruptions in logistics networks as well as the temporary shutdown of factories. In the face of such challenges, most companies' tactics are quite similar to their tactics in China which are enhancing communications with current suppliers to mitigate order-related risks, coming up with new risk management strategies to better control unexpected events, and diversifying sourcing bases to mitigate supply chain disruptions.

Heading into the future, all companies must assess their own unique situation and internal requirements for their sourcing operations. Regardless of which strategy companies opt for, collecting sufficient information and market data to base their decisions upon remains the most important challenge.



Thanks

We would like to extend our sincere thanks to the all participants for their contribution in making this survey a successful project.

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Contact Us



Shanghai Office

Address: Room 605, Bund Center,
No.222 East Yan'an Road, Huangpu
District, Shanghai 200002, China

中国上海市黄浦区延安东路222号外滩中心
605室,
邮编: 200002

Tel: +86-(0)-21-340-106-10

Email: shinfo@asiaperspective.net

Zhongshan Office

Address: No. 23, Tongji West Road, Nantou
Town, Zhongshan City, Guangdong Province,
China 528427

Tel: +86 760 2251 8150

Email: zsinfo@asiaperspective.net

Ho Chi Minh City Office

Address: Dreamplex, 62 Tran Quang Khai,
Tan Dinh Ward, District 1,
Ho Chi Minh City, Vietnam

Tel: +84-28-7301-3900

Email: vninfo@asiaperspective.net

Helsinki Representatives

Johan Hackman:
Tel: +358 400607378
Email: johan.hackman@asiaperspective.net

Beijing Office

Address: 25 / F, digital 01 building, No. C 12,
Guanghua Road, Chaoyang District, Beijing
100020, China

Tel: +86-(0)-185 0048 6766

Email: beijinginfo@asiaperspective.net

Hong Kong Office

Address: Room 1002, 10/F., Golden Gate
Commercial Building, 136-138 Austin
Road, Tsimshatsui, Kowloon, Hong Kong

Tel: +85-(0)-227-399-698

Email: hkinfo@asiaperspective.net

Stockholm Office

Address: Malmkillnadsgatan 32
Stockholm, AB 111 51, Sweden

Tel: +46-(0)-70-769-92-07

Email: stockholminfo@asiaperspective.net

Sami Lindstrom:
Tel: +358 405774344
Email: sami.lindstrom@asiaperspective.net