

Global Sourcing for Electric and Gas Utilities

Emerging Trends and Opportunities to Help Drive Savings



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Introduction

More than ever before, Global 1000 organizations rely on procurement to provide incremental sources of value—and electric and gas utilities are no different. With evolving supplier capabilities and the advancement of new global markets and technologies, organizations are now able to search the world for additional savings opportunities in their ongoing effort to manage costs and drive more value for the enterprise.

Global sourcing for electric and gas utilities has its own unique intricacies. The expansion of supply channels to a global marketplace is most often geared toward low-cost multinational purchasing in order to reduce end-user costs. This whitepaper will examine these key considerations for sourcing globally:

- Trends in global sourcing: general and utility-specific.
- Key countries and products for low-cost sourcing.
- Approaches to overcoming challenges used by successful organizations.
- Success factors for utilities.

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General Trends in Global Sourcing

By definition, global sourcing is the practice of sourcing from global markets for goods and services. Low-cost-country sourcing (LCCS), considered a subset of global sourcing, is driven mainly by global economic factors and the integration of the global economy. Numerous companies worldwide have achieved significant cost reductions through LCCS. Whether global sourcing is for an electric and gas utility or another sector, the following are a few key drivers that should be considered:

- **Cost Reduction:** Finding low-cost labor and raw-material efficiencies.
- **New Supply Sources:** Finding better supply sources around the world that provide higher quality.
- **Sourcing for Local Global Markets:** Finding global sources of supply to support local global operations.

Before looking at utility-specific sourcing, let's first examine some general trends and additional considerations related to global sourcing.

1) Cloud Environment: The move toward cloud technology is facilitating greater global sourcing, particularly in the IT services sector. Increasingly, Global 1000 companies have been moving portions of data and functions to public cloud services because of reduced costs and relative ease of use. According to a recent survey of outsourcing contracts, the sourcing of IT services globally has increased 172 percent in the last two years alone.

2) Political Pressures and Economic Shifts: The rise in political pressures and economic shifts has had a tremendous impact on global sourcing. Increases in governance and risk-management mandates—particularly in the financial-services industry—have added to the complexity and demands of global sourcing. For example, bankruptcy in many Asian countries resulting from the 1999 financial crisis led to rapidly declining currencies. Political unrest in Middle East and North African countries has the potential to create an unfavorable environment for building business relationships.

3) Reshoring Production to US: As the labor-cost arbitrage begins to narrow, some companies are bringing production back to the US as an act of national economic support. Google recently announced that the Nexus Q would be made in the US, putting pressure on competitors to follow suit. Other Fortune 500 companies, including Dow Chemicals, Caterpillar, General Electric, and Ford Motor Company, have also begun to move some of their manufacturing back to the US.

4) Nearshoring and Rural Sourcing: Another trend affecting global sourcing programs is a resurgence of nearshore and rural sourcing initiatives. For the US, nearshore sourcing is primarily focused on Canada and Latin America, including Mexico, in an effort to lower costs without the logistical complexities associated with longer lead times from more distant locations. Rural sourcing has recently become effective for companies that can take advantage of the lower labor costs in rural US locations without having to incur the costs and complexities associated with global sourcing.

5) Growth in Spite of Trends: In spite of external factors, such as political pressures and economic shifts, global sourcing continues to grow exponentially. In fact, by 2020 projections show that there will be \$800 billion to \$1 trillion in new global sourcing.

Utility-Specific Trends in Global Sourcing

When sourcing globally, the utility industry trails other sectors. However, this is expected to increase significantly in the areas of manufactured products and outsourced services/technology. Here are a few of the categories that are most often globally sourced by utilities:

- **Complex engineered electrical equipment, including power transformers and high-voltage circuit breakers.** From 2005 to 2011, large power transformer (LPT) imports to the US grew 188 percent.
- **Insulated and Transmission Wire and Cable.** Importing products from low-medium voltage manufacturers in China and Korea, directly and through distributors, offers a potential savings of 15 to 20 percent. US demand is expected to rise 5.8 percent annually through 2017 with China the primary source of supply.
- **Services, including application development services, call centers, and finance and accounting services.** The growing cloud environment trend discussed earlier is a key driving factor in this category.

- **Fabricated Structures.** Structures such as labor-intensive lattice transmission towers are natural candidates for sourcing from Mexico, Brazil, India, and China with a potential savings of 15 to 20 percent.

New categories of utility-specific products, such as pipes, valves and fittings, and MROs (maintenance, repair, operations), are being explored around the world. However, not all utility-specific products and services lend themselves to global sourcing. For example, sourcing in the US is a better option for bulky items that involve little labor in their production, construction services, and/or other on-site activities.

The savings from sourcing globally are proven, and many utilities benefit from properly executed global sourcing initiatives. Recently a \$10 billion US utility with nearly \$100 million spend per year on power transformers sourced high-voltage units from China and Korea. As a result, they achieved more than 15 percent in net savings. Including new suppliers in the bidding process also helped them drive down prices from their incumbent suppliers.

Key Countries and Products for Low-Cost Sourcing

Each country has unique offerings—advantages, opportunities, and challenges. When considering low-cost utility sourcing on a global scale, keep in mind these key factors:

Key Countries/Products for Low-Cost Sourcing

	CHINA	INDIA	KOREA	MEXICO & BRAZIL
SNAPSHOT	• Large supply base of government-owned and privately held companies	• Emerging base of suppliers	• Experienced, export-oriented supply base	• Domestic and multinational suppliers
KEY PRODUCTS & SERVICES	• Transmission; distribution of electrical equipment, wire and cable as well as metal-fabricated structures, pipes, valves and fittings	• Metal-fabricated structures, pipes, valves and fittings; application development and other IT services, F & A and call centers	• Transmission; distribution of electrical equipment, wire and cable as well as gas transmission pipes	• Selected transmission, distribution of electrical equipment and metal-fabricated structures
KEY STRENGTHS	• Competitive prices and abundant engineering talent	• Competitive prices and proficient English-language skills	• Competitive prices and positive track record in the US	• Competitive prices and proximity to North America
KEY CHALLENGES	• Trade Tensions and lack of English-language capabilities	• Small size and scale of companies	• Currency fluctuations and geopolitical risk	• Currency fluctuations, relatively concentrated supply base, small size and scale of companies

Overcoming Challenges: Approaches Used by Successful Organizations

Instead of re-inventing the wheel, utilities have an opportunity to learn from early adopters of low-cost-country sourcing, such as electronics companies and telecom operators. Leading companies like Vodafone and Deutsche Telekom have overseas offices with dedicated supply chain, engineering, and quality assurance staff to support the sourcing, supplier qualification, and product quality control processes.

Here's how successful organizations have met the challenges of global sourcing:

Meeting the Challenges of Global Marketing

Challenges	Responses
<ul style="list-style-type: none">• Supplier Relationship Management	<ul style="list-style-type: none">• Proactive and frequent communication with foreign suppliers to avoid misunderstandings. A successful organization may have a dedicated team that travels abroad regularly to understand supplier operations.
<ul style="list-style-type: none">• Product Quality: Organizations, particularly utilities, need rigorous processes to ensure product quality and conformance to specifications.	<ul style="list-style-type: none">• Clearly defined quality expectations and performance standards. This is most important in the early stages of the relationship as organizations qualify new suppliers, conduct quality audits, provide suggestions for improvements and perform progress reviews.
<ul style="list-style-type: none">• Supply Chain Risk: This includes political instability, natural disasters or rapid changes in economy and/or currency.	<ul style="list-style-type: none">• Source from multiple countries to mitigate supply chain risks in addition to building adequate contingency plans and performing risk analyses.
<ul style="list-style-type: none">• Logistical Complexities & Lead Times: Sourcing globally can add 20 to 50 days to standard lead times.	<ul style="list-style-type: none">• On-hand inventory increases to cover demand during replenishment times through accessibility to and use of multiple suppliers.

Success Factors for Utilities

The following are the most significant factors for helping to ensure the success of utility organizations embarking on low-cost-country sourcing initiatives.

1) Secure Executive Commitment: Senior executives need to reinforce the importance of global sourcing initiatives so that they are adopted companywide. Without executive support, the importance of any initiative can be minimized at the expense of sustainability. Executive commitment within the organization will send a clear signal to existing and potential suppliers and help overcome potential internal resistance.

2) Build Essential Skillsets and Do Your Homework:

It is critical to build a proper framework for success by having the right people, processes, and technology in place by:

- Ensuring your organization has the skillsets necessary to identify, qualify, negotiate, and manage foreign suppliers effectively.
- Analyzing risks and liabilities.
- Understanding the range and nature of potential suppliers.
- Using total cost modeling (TCM) for true comparisons.

3) Include Multinational Suppliers: Evaluate savings with incumbent supplier plants in low-cost countries to save the time and expense of evaluating new suppliers.

4) Conduct Supplier Visits: Do not rely solely on RFIs, RFPs, and long-distance communication, as this could be costly later. Keep in mind that site visits are especially important early in the relationship with a new supplier.

Conclusion

Sourcing globally for the electric and gas utility industry has a unique set of challenges as well as significant opportunities to reduce spend and capture savings. Done properly, a global sourcing initiative offers significant value potential to most organizations. The information in this whitepaper is designed to help you streamline efforts and achieve long-term success that drives efficiency and effectiveness for your organization year over year.

Learn more about ProcureAbility's Utility-Specific Market Intelligence today!

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