

Supplier development and cost management in Southeast Asia—Results from a field study

Marc Wouters*, Ewout van Jarwaarde, Bianca Groen

University of Twente, Capitoel A101, P.O. Box 217, 7500 AE Enschede, The Netherlands

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Abstract

This paper is about supplier development when international companies have production sites in Southeast Asia and look for opportunities to switch from international suppliers to local suppliers. We conducted a field study involving site visits to companies in Thailand and Vietnam, and interviews at corporate supply chain departments. Some key observations are: cost management was a dominant motive for taking local supplier development initiatives. Furthermore, local sourcing and local supplier development were important for international companies to improve access to local customer markets. Firms deliberately assessed whether a particular supplier would likely be able to improve sufficiently to warrant investing in supplier development, which typically involved a combination of initiatives, requiring the international firm to take considerable efforts. Local sourcing strategies and priorities for supplier development initiatives tended to focus on items with low supply risk and low volume. These findings are discussed based on transaction cost economics, and we suggest that firms use several ways to reduce the risk of transaction-specific investments in supplier development initiatives.

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1. Introduction

Economies in Southeast Asia are developing rapidly and with rising spending power in these countries, international companies are catering to the taste of local consumer markets. Sourcing from local suppliers can help to create access to these local consumer markets (Kotabe and Zhao, 2002). Therefore, many international companies aim to increase local sourcing in Southeast Asia (Humphreys et al., 2004). However, required investments in supplier development and uncertainty about supplier capabilities and potential for improvement hamper the development of a local supply base in Southeast Asia. Not much research on supplier development has addressed these challenges yet (Humphreys et al., 2004).

In this paper, we present results of a field study of supply chain experiences of international companies in Thailand and Vietnam. More specifically, this paper is about *local supplier development* by international companies in Southeast Asia. Krause and Ellram (1997) defined supplier development as “any effort of a buying firm with its supplier(s) to increase the performance and/or capabilities of the supplier and meet the buying firm’s short- and/or long-term supply needs” (p. 21). *Local* supplier development in this study refers to settings where international companies have production activities in Southeast Asia and are in the process of working with locally owned and managed suppliers in Southeast Asia to substitute imported supplies from their international suppliers. These local suppliers are situated in the same country in Southeast Asia as the buyer, although sometimes transportation issues may lead companies to focus on a smaller part of the country. On the other hand, when the ASEAN Free Trade Area (AFTA) will come into effect, the area for selection of

*Corresponding author. Tel.: +31 53 4894498.

E-mail address: m.j.f.wouters@utwente.nl (M. Wouters).

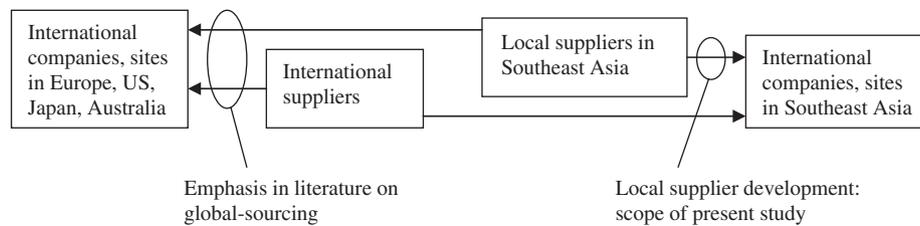


Fig. 1. Scope of supplier development in this study.

suppliers for supplier development initiatives may extend to the AFTA region (or part of it) and, thus, it may become larger than just one country.¹ The scope of this paper is illustrated in Fig. 1. Note that “local suppliers” does not refer to suppliers that have local production sites that are owned and managed by international companies.

Most of the literature on sourcing and supplier development has focused on (a) supplier development in Europe, North America or Japan, undertaken by international companies, and (b) supplier development for sourcing in low-cost countries to supply to sites in Europe, North America, or Japan. Besides, many studies are based on data gathered through questionnaires (e.g., Boddy et al., 1998; Cho and Kang, 2001; Handfield, 1994; Krause and Ellram, 1997; Modi and Mabert, 2007; Rajagopal and Bernard, 1994). We argue that there is a need to also focus on local supplier development and conduct field-based empirical research investigating practical experiences with supplier development. Existing knowledge about supplier development may need to be adjusted to the context of Southeast Asia.

The purpose of this paper is to provide descriptive results on motives, priorities, and practices for local supplier development in Southeast Asia, based on a series of site visits, and to relate these findings to existing supplier development literature. It specifically explores how supplier development activities are influenced by lack of readily available local suppliers, which creates the need for relation-specific investments under uncertainty.

¹Ten countries (Thailand, Singapore, Vietnam, Indonesia, Malaysia, Brunei Darussalam, Malaysia, Laos, Cambodia and Myanmar) in Southeast Asia are members of the Association of South East Asian Nations (ASEAN). The ASEAN Free Trade Area (AFTA) was established in January 1992 to eliminate tariff and non-tariff barriers among the Southeast Asian countries. The target of the AFTA is the elimination of all import duties by 2010. Next to import duties, quantitative restrictions and non-tariff barriers (technical and administrative barriers) should also be eliminated. Technical barriers can take many forms; for example, governments can require imported manufactured products to meet national standards that are different from international standards, impose local testing and certification procedures which are time consuming and add additional expense. Examples of administrative barriers include restrictions on foreign ownership, licensing requirements, lack of transparency, excessive documentation, and long lead times required to obtain the necessary government approvals. We could identify only a few papers on supply chain management and free-trade agreements, on NAFTA in particular (Fawcett et al., 1995; Greenwold, 1994; Myers et al., 1996; Nichols and Taylor, 1995; Wailer and Emmelhainz, 1995) but no research papers on AFTA.

The paper is structured as follows. A literature review and the research questions are presented in Section 2. The research method is described in Section 3. Section 4 contains results related to supplier development, and these are organized around four themes that emerged during the analysis of the findings: motives and priorities for supplier development initiatives, ways in which the firms in our sample undertook such initiatives with suppliers, and further insights obtained through follow-up interviews at corporate headquarters of three of participating international companies. The observations presented in Section 4 form the basis for the discussion in Section 5. Section 6 concludes the paper.

2. Research questions and literature review

In this section, the research questions are formulated based on the intended contribution to the literature. We aim to be specific about the unique characteristics of the Southeast Asian setting that motivate more research about local supplier development.

2.1. Motives for supplier development

Research on motives for supplier development is often conducted in the context of global sourcing. Improved technology and intensified competition have enabled and forced companies to use worldwide sources for acquiring raw materials and components (Zeng and Rossetti, 2003). The emergence of free-trade zones like NAFTA, EU and AFTA may also stimulate international purchasing and inter-zone trade (Handfield, 1994). Much of the literature addresses global sourcing, especially sourcing from low-cost suppliers in Southeast Asia, to substitute suppliers in Western countries (e.g., Arnold, 1999; Cho and Kang, 2001; Handfield, 1994; Rajagopal and Bernard, 1994; Zeng and Rossetti, 2003). Important reasons to source globally are lower prices, increased competition, better quality, increased number of sources, and access to worldwide technology (Rajagopal and Bernard, 1994). Global sourcing puts emphasis on supplier development, because new suppliers in other regions of the world may not yet meet the requirements of international companies (Handfield, 1994).

However, motives for local sourcing in Southeast Asia to supply local production activities may differ from motives for global sourcing (Kotabe and Zhao, 2002). Customer markets in Southeast Asia are expanding rapidly, and local

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