

# Strategy Plays Key Role in Mid-Tier Supply Chain Management



by Susan Mucha

## IN SUMMARY

There is merit to the idea that larger firms get better material pricing and larger allocations of critical components than their smaller counterparts. They also often have better global procurement capabilities. But, since raw material cost is often 60 to 75% of unit price, why haven't the big fish emptied the pond by now?

I frequently see articles quoting tier-one EMS providers and industry pundits discussing the likely demise of smaller EMS segments because of their inability to competitively price materials. Yet, just like predictions of the end of the world that never come to pass, regional players continue to attract new customers and enjoy continued growth.

There is merit to the idea that larger firms get better material pricing and larger allocations of critical components than their

smaller counterparts. They also often have better global procurement capabilities. Since raw material cost is often 60 to 75% of unit price, why haven't the big fish emptied the pond by now?

There are several reasons:

- **Raw material unit cost is just the tip of the iceberg.** Unpredictable and/or lower-volume projects may see more competitive total cost and less liability with a smaller contractor who is expert at structuring supply changes capable of supporting high mix, low volume.

- **High mix, variable demand can be logistically inefficient over long distances.** Depending on location and end market support strategy, some OEMs prefer to source these projects regionally. Regional warehouse kanbans or direct shipment to end customers are options for addressing this issue, but these types of strategies can increase contractor cost.

- **One size really doesn't fit all.** The largest players are strategically driven by their largest customers. Business models exist for higher-mix, variable-demand production, but



a \$5 to \$10 million spend in a \$2 billion+ contractor isn't going to get the same mindshare and business model flexibility driven by a \$100 million customer.

- **Larger players have better purchasing power, but they also have the higher cost structures that come with global footprints.** Regional players may have lower cost structures. As one Asia-only EMS provider executive asked me, "Why pay for factories you don't need?"

- **Some OEMs recognize that dividing the business among a mix of suppliers keeps the market competitive.** If the EMS industry ever did shrink to two to three major players, prices would rise.

- **The rules are often different at larger offshore suppliers.** While OEMs tout the price competitiveness of building in a low-labor-cost country, the payment terms may be far different from those of a regional supplier. In some cases, inventory is reconciled quarterly and customers pay for any raw material in excess of that quarter's forecast. Ownership may transfer at the contractor's dock, increasing the amount of finished goods inventory held by the customer.

That said, the only reason to divide the mix of business is to more efficiently source. Achieving that goal requires careful study of the systems and processes that make a specific contractor the right fit for the business.

What systems and strategies help regional EMS providers compete in the supply chain management realm?

- **Leverage supplier support resources to reduce total cost.** Distributors can be sources of component life cycle analysis information, technology trends, in-house stocking programs, proximity warehouses and other services that improve program efficiency. While the amount of value-add they provide is often tied to an EMS providers' total spend, companies that take time to understand what options may be available tend to

negotiate better partnering arrangements than companies who just accept what is offered based on their projected spend. In short, good negotiators who understand their options tend to leverage their distribution resources better and can often pass on some of that value in reducing customer hidden costs.

- **Engage in frontend materials analysis.** Sole-sourced parts, over-spec'd custom components, components nearing end-of-life and heavily allocated component types all drive cost. Frontend analysis of the bill of material (BOM) and approved vendor list (AVL) can improve supply chain efficiency from day one and drive down overall product cost throughout the product lifecycle by reducing risk and maintaining "competitive tension" in the supply chain.

- **Look for suppliers willing to work in a variable demand environment.** There is usually more margin in higher EMS companies that often develop good networks off these suppliers.

- **Provide sustaining engineering support.** Many high-mix, variable-demand products also have long life cycles. Strong focus on value-added/value engineering (VA/VE) and obsolescence management help reduce cost over time. Mid-tier EMS providers often use expertise in this area as a point of differentiation. Successful VA/VE initiatives provide a roadmap for continuous cost improvement for OEM customers, while simultaneously improving EMS margins. Larger EMS firms typically have substantial resources in this area, but are generally less interested in the size of project that is attractive to mid-tier firms for mid-tier OEM customers.

### Viewing These Principles in Action

[EPIC Technologies](#) and [Burton Industries, Inc.](#) represent two examples of mid-tier EMS companies with focused supply chain management strategies.

EPIC Technologies is headquartered in Denver, Colorado, and has factories in Norwalk, Ohio; Lebanon, Ohio; and Juarez,

## STRATEGY PLAYS KEY ROLE IN MID-TIER SUPPLY CHAIN MANAGEMENT *continues*

Mexico. According to Todd Baggett, Vice President of Supply Chain Management, EPIC's commodity management strategy focuses on:

- Developing strategic suppliers who understand Lean philosophies
- Developing global pricing and terms to provide flexibility in sourcing regions;
- Continuous performance monitoring; and
- Emphasis on technical procurement support for customers.

However, the commodity management team is also customer-issue focused. In selecting suppliers, commodity managers also evaluate the ability of suppliers to meet customer-related objectives such as efficient lean deployment, product development support, supply protection and continuing cost competitiveness.

Design for procurement and VA/VE are also key points of focus in EPIC's Lean philosophy. Their team uses both internal resources and leverages supplier expertise in analyzing component lifecycles and trends. In some cases, suppliers provide in-house seminars on technology roadmaps and trends.

Burton Industries' factory is in Ironwood, Michigan, and administrative activities and sales are handled in a facility in Hazelhurst, Wisconsin.

The company recently founded a supplier consortium known as the WIN Alliance to better address customer needs. According to

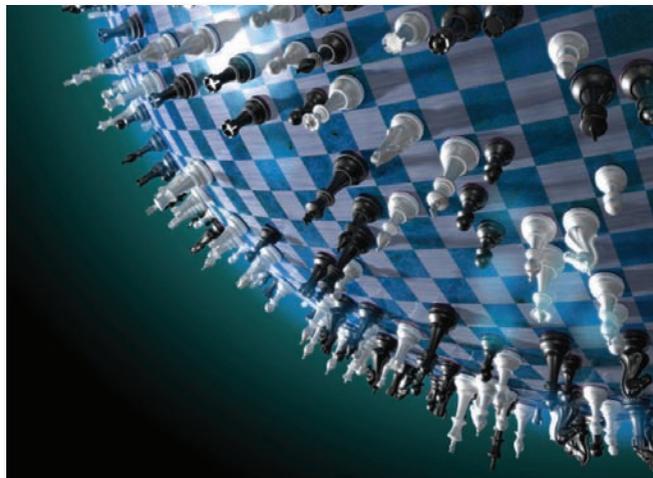
Gary Burnett, Sr., Burton Industries' CEO, customer trends that drove their interest in creating the alliance included:

- Greater focus on total cost including the opportunity cost associated with the lack of schedule flexibility;
- A requirement for shorter lead-time driven by lack of demand predictability combined with concerns over inventory;
- Changes in business or product focus driven by the combination of an economic downturn and state economic incentives to add product lines that create jobs within the region;
- A growth in local start-ups looking to keep jobs in the region; and
- Economic pressure on companies to focus on core competencies and outsource capital intensive business activities such as manufacturing.

Alliance partners needed to meet very specific criteria:

- A strong ability to support new product introduction (NPI);
- The ability to scale production resources with project growth;
- Local presence in the region and, in some cases, the ability to support offshore production in higher volumes; and
- Supplier business model that aligns with Burton's customer niches and includes a high focus on customer service, quality and a willingness to meet Burton's metrics for schedule flexibility/customer service.

Alliance partners now include a tooling and plastics injection molding firm with both U.S. and Asia manufacturing capabilities, a manufacturer of soft-sided cases, a conformal coating supplier and two offshore electronics manufacturing partners. In the alliance business model, Burton's materials and program management personnel manage the alliance partners so that customers have a central point of contact. The prime difference between a typical supply chain relationship



**STRATEGY PLAYS KEY ROLE IN MID-TIER SUPPLY CHAIN MANAGEMENT** *continues*

and the alliance is the fact that common processes for project launch and production management are in development, eliminating the learning curve that occurs with a larger pool of suppliers. Additionally, alliance partners must be willing to support customer requirements for smaller lot sizes and greater flexibility.

“Our customers get a very flexible one-stop shop with internal program management and engineering resources to support their product. They also get a team of key suppliers who work as an extension of our team. While we may mix and match the partners based on project requirements, we work under a common operating framework to provide high-quality, focused support,” Burnett added.

In both examples, a need to meet specific customer challenges has driven a

highly-focused approach to supply chain management. Material cost competitiveness is driven by efficient supply base support arrangements, and elimination of inefficiencies in product launch and sustaining production. **SMT**



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## Global Industrial Manufacturing M&A Value Up 70% in Q2

Merger and acquisition (M&A) value increased 70% in the industrial manufacturing sector during the second quarter of 2011, according to Assembling Value, a quarterly analysis of M&A activity in the global industrial manufacturing industry by PwC US. In the second quarter of 2011, there were 46 deals that were worth more than \$50 million with a total deal value of \$18.6 billion, compared to 33 deals and \$9.8 billion in the second quarter of 2010. Average deal value was relatively flat at \$400 million in the second quarter of 2011 compared to the prior quarter and up from \$300 million in the same period of 2010.

In the first six months of 2011, both deal volume and value were up with 86 deals (worth more than \$50 million) and a total value of \$35.9 billion, an 83% increase in volume and 197% increase in value when compared to the 47 deals worth \$12.1 billion in the first six months of 2010.

In the second quarter of 2011, U.S.-affiliated transactions dominated M&A activity for deals worth more than \$50 million, making

up 41% of total deal volume and 66% of total deal value, with 19 deals with a total deal value of \$12.3 billion.

According to PwC, mega deal activity, or transactions worth \$1 billion or more, was entirely driven by strategic investors in the second quarter of 2011, confirming the strong desire of these companies to realize growth through acquisitions. During the second quarter of 2011, there were three mega deals with a total value of \$7.7 billion, compared to three mega deals worth \$4.4 billion in the second quarter of 2010.

For deals worth \$50 million or more, the industrial machinery category was the primary driver of deal activity with 61% and one of the three mega deals in the second quarter of 2011. Despite contributing the remaining two mega deals, the number of rubber and plastics products deals decreased during the second quarter of 2011 with four deals worth \$3.53 billion, compared with four deals worth \$0.65 billion in the second quarter of 2010.

For a copy the report, visit [www.pwc.com/us/industrialproducts](http://www.pwc.com/us/industrialproducts).