

11.4: Global Sourcing and Distribution

Learning Objectives

After reading this section, students should be able to ...

1. outline the advantages of global sourcing.
2. know the pros and cons of sole-sourcing and multisourcing.
3. describe the distribution-management choices companies have when entering new international markets.

Global sourcing refers to buying the raw materials or components that go into a company's products from around the world, not just from the headquarters' country. For example, Starbucks buys its coffee from locations like Colombia and Guatemala. The advantages of global sourcing are quality and lower cost. Global sourcing is possible to the extent that the world is flat—for example, buying the highest-quality cocoa beans for making chocolate or buying aluminum from Iceland, where it's cheaper because it's made using free geothermal energy.

When making global-sourcing decisions, firms face a choice of whether to sole-source (i.e., use one supplier exclusively) or to multisource (i.e., use multiple suppliers). The advantage of sole-sourcing is that the company will often get a lower price by giving all of its volume to one supplier. If the company gives the supplier a lot of business, the company may have more influence over the supplier for preferential treatment. For example, during a time of shortage or strained capacity, the supplier may give higher quantities to that company rather than to a competitor as a way of rewarding the company's loyalty.

Student Example

Nestlé is a global company, comprising brands such as Kit Kat, Nesquik, and Stouffer's, as well as other food brands and baby formulas. To source their raw materials, they follow a multisource model. A specific example within Nestle is that they are sourcing some of their global palm oil from five smallholder farms in Indonesia, Malaysia, Ghana, Côte d'Ivoire, and Peru. This multisourcing benefits Nestlé because they can source their palm oil from various countries, allowing for a supply chain with less uncertainty. If one palm oil supplier were to go out of business or provide less than expected, one of the other suppliers would be able to make up for the slack. A side benefit is these smallholders gain a foothold in the global market.

Zach Harper

Class of 2020

On the other hand, using multiple suppliers gives a company more flexibility. For instance, if there's a natural disaster or other disruption at one of their suppliers, the company can turn to its other suppliers to meet its needs. For example, when Hurricane Mitch hit Honduras with 180-mile-per-hour winds, 70 to 80 percent of Honduras's infrastructure was damaged and 80 percent of its banana crop was lost. Both Dole Food Company and Chiquita bought bananas from Honduras, but Dole relied more heavily on bananas from Honduras than from other countries. As a result, Dole lost 25 percent of its global banana supply, but Chiquita lost only 15 percent.¹

Sole-Sourcing Advantages

- Price discounts based on higher volume
- Rewards for loyalty during tough times
- Exclusivity brings differentiation
- Greater influence with a supplier

Sole-Sourcing Disadvantages

- Higher risk of disruption
- Supplier has more negotiating power on price

Multisourcing Advantages

- More flexibility in times of disruption
- Negotiating lower rates by pitting one supplier against another

Multisourcing Disadvantages

- Quality across suppliers may be less uniform
- Less influence with each supplier
- Higher coordination and management costs

Whichever sourcing strategy a company chooses, it can reduce risk by visiting its suppliers regularly to ensure the quality of products and processes, the financial health of each supplier, and the supplier's adherence to laws, safety regulations, and ethics.

✓ Ethics in Action

The Case of Global Sourcing

While there is little systematic research on questions related to ethics and global sourcing, one recent survey in the context of clothing manufacturers identified the following most encountered issues:²

- **Child labor.** Forty-three percent of the respondents had encountered factories where child labor was being used. India, China, Thailand, and Bangladesh were cited as the worst offenders in this regard, partly because of the absence or unreliability of birth certificates, but also because of the difficulty that Westerners have in assessing the age of workers in these countries. Buyers relied on the management of the factory to check on documents supplied by the employee.
- **Dangerous working conditions and health and safety issues.** Forty-three percent of the respondents had encountered dangerous working conditions in factories. These included unsafe machinery (e.g., machine guards having been removed to speed up production), workers failing to use safety equipment such as cutting gloves, and the use and storage of hazardous chemicals (e.g., those used for dyeing and printing). Fire regulations were also sometimes inadequate, both in factories and in the dormitory accommodation often provided for workers who live away from their home regions. Sometimes fire exits were locked, and fire extinguishers were missing.
- **Bribery and corruption.** Thirty-one percent of respondents said that they had experienced bribery and corruption. One blatantly fraudulent practice mentioned was for suppliers to mislead the buyer over the true source of production. Many suppliers claim that goods are made in one factory, then transfer the production elsewhere, making it difficult for the retailer to audit.
- **Exploitation of the workforce.** Twenty-five percent of respondents mention some aspect of exploitation of the workforce, encompassing the issues of child labor and health and safety. However, it can also cover low wages being paid to workers and excessive overtime being expected by employers. Respondents specifically mentioned that they had encountered worker exploitation. Many spoke of long working hours in factories, especially at peak periods, with employees often working over seventy hours per week.

✓ Student Example

Apple uses global sourcing to acquire most of their products. I learn that their products are made in factories in China. In the past, they have allegedly experienced ethical issues, like child labor and dangerous working conditions. It was reported in the news that they had children working in those factories. Also, they were allegedly working in very harsh conditions; so harsh that workers started committing suicide. If this is true, global sourcing can be risky for the reason that they may not have complete control over what happens in the factories, and might not even know what goes on inside them.

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Distribution Management

Selling internationally means considering how your company will distribute its goods in the market. Developed countries have good infrastructure—passable roads that can accommodate trucks, retailers who display and sell products, and reliable communications infrastructure and media choices. Emerging markets, on the other hand, often have very fragmented distribution networks, limited logistics, and much smaller retailer outlets. Hole-in-the-wall shops, door-to-door peddlers, and street vendors play a much larger role in emerging-market countries. In the emerging countries of Africa, for example, books might be sold from the back of a moped.

In addition, the standards of living in emerging countries vary widely. Most of the middle class lives in cities, but the percentage of the population that lives in rural areas varies by country. In India, 70 percent of the population lives in rural areas, whereas in Latin America only 30 percent does.

Rural logistics are especially problematic. Narrow dirt roads, weight-limited bridges, and mud during the rainy season hamper the movement of goods. An executive at computer storage device manufacturer EMC noted that sometimes the company's refrigerator-sized, data-storage systems have had to be transported on horse-drawn wagons.

How Nokia Tackles Distribution Challenges

Nokia is a \$59 billion company with over 123,000 employees.³ It sells 150 different devices, of which 50 to 60 are newly introduced each year. Each device can be customized on many variants, including language and content. This variation adds greatly to the devices' complexity; three hundred to four hundred components need to arrive on time at factories in order for the devices to be built. Approximately one billion people use Nokia devices worldwide. Countries like China, India, and Nigeria, which ten years ago had almost zero penetration of mobile phones, now have twenty million to forty million users each. Emerging markets now account for over half of Nokia's annual sales.

Nokia has the challenge of selling a growing variety of mobile devices in hundreds of thousands of tiny retail outlets in the developing world. To tackle reaching its rural customers in developing countries, Nokia has 350,000 points of presence in rural areas, from small kiosks and corner shops to organized retail outlets. Nokia has 100,000 such point-of-sale (POS) outlets in India, 80,000 in China, and 120,000 in the Middle East and Africa.

To train salespeople in developing countries, Nokia created an internal university to educate the people who sell its phones in these POS locations—an average of five people per location. Nokia Academy teaches local salespeople about the features of the phones and how to sell them. As Nokia expands further into these emerging markets, it will penetrate deeper into the rural areas and will distribute through local providers.

Nokia's challenge is to maintain its strong brand name—the fifth most recognized brand in the world—across these POS locations. Meeting this challenge has taken years. One way that Nokia maintains control of its brand across these locations is by having managers visit the outlets on a regular basis and using their mobile phones to photograph the shelf layout at each location. This lets Nokia control quality and improve merchandizing techniques at all locations.

Distribution-Management Choices: Partner, Acquire, or Build from Scratch

There are typically three distribution strategies for entering a new market. First, companies can do a joint-venture or partnership with a local company. This is the strategy Walmart used when entering Mexico. A second strategy is to acquire a local company to have immediate access to large-scale distribution. The Home Depot pursued this strategy in China when it acquired a partner with whom it had been working for quite some time. Third, a company can build its own distribution from scratch. Retailer Carrefour chose this route in China years ago, because it knew China would offer a big opportunity, and Carrefour wanted to develop its own local capabilities. Which strategy the company chooses depends on its timetable for volume in the market, local foreign-ownership laws, and the availability of suitable partners or acquisition targets.

? Spotlight on International Strategy and Entrepreneurship

Unilever Solves Distribution Issues in India

Hindustan Unilever Limited (HUL), Unilever's Indian subsidiary, wanted to reach the 70 percent of Indians who live in rural villages. This underserved market is very hard to reach. Not only is marketing to remote villages difficult, but the physical transport of products is no easier. Most of the villages lack paved roads, making traditional truck-based distribution arduous. The only way to reach many of these remote villages is by single-track dirt trails.

In response to these conditions, HUL has created Project Shakti (the word means "strength") and developed a network of 14,000 women and women-owned cooperatives to serve 50,000 villages. The women handle the logistics and door-to-door retailing of a range of personal-care products. To address the needs of the market and this novel distribution system, HUL has packaged its products in much smaller sizes. The effort has created \$250 million in new revenues for HUL, of which 10 percent is used for financing the women entrepreneurs. By using this approach, HUL doesn't have to deal with the problem of moving products in rural India. The women or their employees come to the company's urban distribution centers to get the products.

? Key Takeaways

- Global sourcing refers to buying the raw materials or components that go into a company's products from around the world, not just from the headquarters' country. The advantages of global sourcing include access to higher quality or lower prices.
- When making sourcing decisions, companies must decide whether to sole-source (i.e., to use one supplier exclusively) or to use two or more suppliers. Sole-sourcing can bring advantages of price discounts based on volume and may give the company greater influence over a supplier or preferential treatment during times of constrained capacity. Sole-sourcing can also bring advantages of differentiation or high quality. The disadvantages of sole-sourcing, however, are that the company faces a higher risk of disruption if something happens to that supplier. Also, the supplier may hold more negotiating power on price.
- A company typically has three distribution strategies for entering a new market—to engage in a joint venture, to acquire a local company, or to build its own distribution network from scratch. Establishing a partnership or joint venture is the least costly approach, followed by acquisition. Building a distribution network from scratch is the most costly and time consuming, but it may give the company the most local experience and capabilities for the long term.
- Distribution channels in emerging markets are less developed, which means that companies may need to seek novel solutions to distributing their products, such as Hindustan Unilever Limited creating its own distribution network of 14,000 female independent distributors and cooperatives or Nokia creating Nokia Academy to train salespeople.

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3. "Nokia Corporation Company Profile," Hoovers, accessed August 6, 2010, <http://www.hoovers.com/company/Nokia...-1-1njdap.html>.

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