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GLOBAL SOURCING STRATEGIES

Introduction

The aim of this article is to give an insight into how Davis Langdon invests in research that is commercialised and brings value innovation to our clients. The Global Sourcing Strategy research commission was completed in Q2 2008 and has since been deployed on select projects as and when is required.

The objectives of the research were to:

- Build contemporary knowledge of procurement issues affecting projects.
- Build contemporary knowledge of market conditions that will affect procurement options.
- Develop a checklist, tool and approach to assist clients considering procuring commodities and/or components from low cost countries.

Context: The why

At the time of the research, there was a global construction boom which resulted in a demand that was outstripping supply in three key areas; commodities (i.e. steel), components (i.e. lifts) and capability (i.e. specialist knowledge/labour). Additionally, a number of emerging economies were catalysing this demand in particular sectors namely, infrastructure, high rise residential and commercial buildings. This was further compounded by a number of global events such as the Olympics and Football World Cups being held in particular developing countries.

Research findings: The how pt 1

The first half of the research was a macro economic study to understand the drivers underpinning the variation in price between countries. Using the Global Competitiveness Index* we were able to analyse the position of countries according to their economic development. This is illustrated in figure 1:

* Published by World Economic Forum

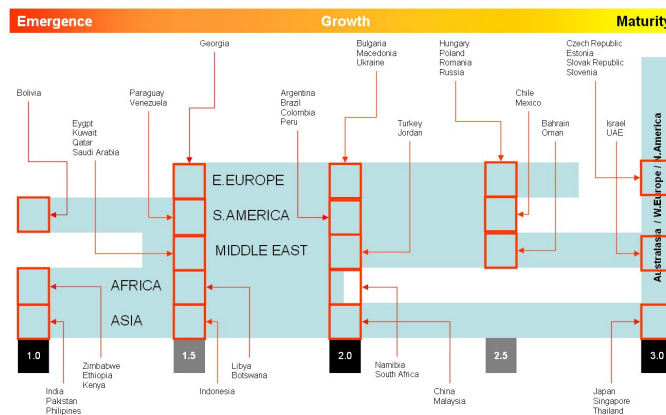


Fig 1: Macro economic development of various countries and regions

This analysis allowed us to understand the following:

- The demand for construction.
- The capacity for each region.
- The sectors within which each region would be experiencing the most construction activity.
- The risk/cost and quality differences between regions.

Following on from this, we looked at the drivers behind the supplier, transaction and buyer to understand the difference between 'price' and 'cost', where price was the amount paid by the buyer and cost to the supplier. This is illustrated in Figure 2.

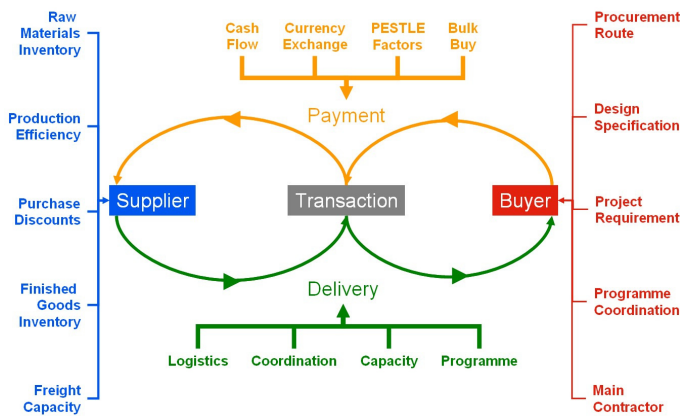


Fig 2: Drivers behind the transaction MIT OpenCourseWare

This analysis also facilitates negotiations to be conducted in the areas of payment and delivery. As a result, these analyses now inform our strategic delivery process to drive down the difference between price and cost.

Research findings: The how pt 2

The second half of the research engaged with the DLSI global network through a survey, to collect data on projects that were over \$200m in value and which had had to procure either structural material, façades or mechanical and electrical services from global sources.

The findings helped us to gain insight on the following aspects:

- The key value drivers behind the need for employing a global sourcing strategy.
- The advantages and disadvantages of undertaking a global sourcing strategy.
- The key locations for structural material (commodity), façades (components) and mechanical and electrical services sourcing (components).

Finally, we developed an approach to commercialise the risks of procuring globally according to the buyer, supplier and transactional drivers. This is illustrated in figure 3.

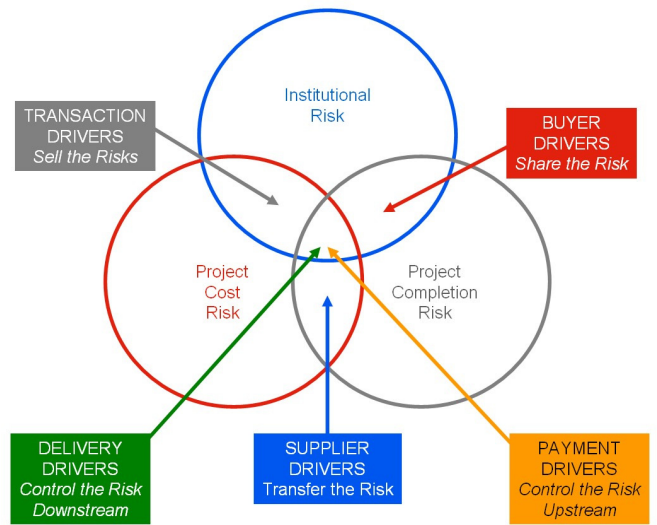


Fig 3: Risk categorisation and strategic opportunities MIT OpenCourseWare

The findings from both parts of the research were then combined into the development of the following tools to support the development of a global sourcing strategy:

- A strategic planning checklist to verify the conditions for a global sourcing strategy are present.
- A currency management tool to account for exchange volatility and assess a hedge play. See figure 4.
- A tactical delivery checklist to guide the implementation of procuring from a global source.
- A tool that generates a shortlist of potential locations for sourcing 23 different products from 140 locations, which meet the project risk profile. See figure 5.

Construction Cost Volatility version B - Lending in PKR, so calculations need to be biased to PKR and not USD as in ver A			
TIME	Construction Budget	\$163,775,640	Pkr 12,774,499,920
	Contingency	\$15,231,135	Pkr 1,188,028,493
	Buying Budget	\$179,006,775	Pkr 13,962,528,413
	Sourcing Location Strategy Split	70% International	30% Local
	Value Split	Pkr 9,773,769,889	Pkr 4,188,758,524
Borrow	Exchange rate	78	1
	Purchasing allowances	\$125,304,742	Pkr4,188,758,524
	Package purchase	\$125,304,742	Pkr4,188,758,524
	Price Escalation	-7.2%	0.0%
	Increase / decrease by	(\$9,021,981)	Pkr 0
	Revised budget	\$116,282,801	Pkr 4,188,758,524
Pay	Exchange rate	1	84
	Exchange rate adjusted	\$116,282,801	\$49,866,173
	Revised budget total	\$106,148,974	Pkr 13,856,613,785
	Extra	(\$12,857,801)	(Pkr 6,014,628)
			(\$17,603)
			-0.04% % over Original Buying Budget

Fig 4: Currency management tool

Fig 5: DLSI procurement model

In addition, we published a number of articles based on our research and findings with the following topics:

- A general commentary on the construction resource shortages which beset South Africa.
- The purchase of façades from China for a museum in the extreme climates of Alaska.
- The costs, risks and benefits of adopting environmentally sustainable design.
- The affordability of infrastructure to emerging economies.
- The procurement and supply chain implications of globalising lift procurement across a development pipeline.
- China as a source of low cost material and the complexity behind procuring from the global marketplace.
- The drivers behind Russia's demand for construction materials and some of the issues affecting development in that territory.

Client mandates: The what

Thus far our approach and tools have been deployed on a number of schemes with two in particular leading to mandates to facilitate a global sourcing strategy.

Project A: Sourcing of materials from location B to A

The project originally adopted the strategy to procure all the materials required for a major cultural building from within the country where the project was located. The architect felt differently and asked us to deploy the procurement tool to verify if this was the case.

Within an hour of being asked, we identified that 50% of the products required for the project could indeed be bought from other locations. Additionally, we found a common location for all 50% that created the conditions for a currency hedge play.

We were subsequently mandated to investigate further options and the potential for a currency hedge, but there was insufficient quantum of material that prevented this.

Project B: Identification of alternative locations

Another major cultural building, the tool was deployed at the start of the procurement process to verify whether a global strategy was required. Across the 20 products covered by the tool, certain locations were identified that could potentially offer a substantial cost reduction.

Upon closer investigation using a risk profile generated from all the stakeholders in the project, it was concluded that a global sourcing strategy was not aligned to the risks appetite of the client team.

Future developments

Current developments of the approach aim to incorporate our procurer and supplier engineering services, which looks to bring a greater degree of sophistication to managing the project supply chain. This in essence revolves around the monitoring of the capacity and capability of the supply chain and the solvency of key suppliers. This becomes an increasing complex task if certain suppliers are located in global locations where macro economic performance data of said suppliers is not available.

This methodology was derived from our work on London 2012 and will result in our global sourcing strategy approach to be adapted to the current market conditions.

Another key area of development is to include a 'carbon miles' calculation, which quantifies the tonnes of carbon produced in transporting construction products globally to the project location by differing transport modality.

Conclusions

As market conditions continue to be challenging, global sourcing, or low cost country sourcing as it's sometimes known as, is becoming an increasingly considered option.

The approach developed is the most sophisticated currently available and the future developments detailed above will ensure its leadership position for a few more years yet. Our approach capitalises on our global knowledge base, which when combined with our innovation core value, produces a genuinely value added product and service that serves our clients better.

For further advice concerning any of the issues raised in this briefing, please contact Neal Kalita at neal.kalita@davislangdon.com, or alternatively one of our other contacts shown overleaf. Information on other property tax related topics can also be found on our website at <http://bankingtaxfinance.davislangdon.com>.