

Doing Business Globally?

Focus CI on Suppliers!

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It's imperative to conduct due diligence on potential suppliers -- and your supplier's suppliers.

"Wei," came the voice over the phone.

"Do you speak English?" I asked.

"Wei?"

"Do you speak Chinese?"

"Wei?"

"That about uses up my language capabilities," I thought as I handed the telephone to an assistant.

The person at the other end of that phone call works at a company which, in the advertisements it runs regularly in major publications, states it has customers all over the globe, as well as skilled, educated workers and state-of-the-art equipment. The ads also say that this company is based in Taiwan.

In truth, as my assistant was to learn, the company was based in Taiwan—five years prior to our telephone conversation. The person I was talking to turned out to be the mother of the factory owner. She could not speak English or Chinese, but conversed in Taiwanese (Fujianese), a dialect peculiar to a small sliver of the Chinese population with ancestry to Fujian Province on the Chinese mainland.

The management of this enterprise had decided to take a calculated risk by advertising itself as a Taiwan company but maintaining only a shell in Taiwan. They did not expect a potential customer to telephone them from the same time zone. All faxes and e-mail correspondence were dutifully forwarded to China from the Taiwan "factory"—actually the boss's house—and answered from China. All telephone calls after working hours (Taiwan is located 12 time zones away from the American Central Standard Time Zone, and most telephone calls after working hours would be made in the middle of the night Taiwan time) were greeted with a nice message—in English—on an answering machine that informed the caller that the factory was closed for the day and calls would be returned promptly the next working day.

As competitive intelligence professionals, we often are tasked with researching competition, searching for new products, market trends, even hiring practices, all the while taking for granted that our own suppliers and vendors have been researched and vetted properly by someone within our own organization.

Most of the time this works. Most of the time, reputable companies will conduct due diligence on potential suppliers and verify that they can do what they say they can do in the time they say they can do it. But as the world shrinks and transactions are conducted more and more via optic fiber and less and less in person, there is room for gaps and slips that can be potentially embarrassing in the best case and tragic in the worst. Particularly vulnerable is the American or European company that wishes to take advantage of the short lead times and cheap communications offered by doing business electronically.

In the case described above, the Taiwanese owner of the factory presented his company as being based in Taiwan. The company had a proper address, was listed in government databases, and had all the proper licenses necessary to do business. Furthermore, his company could produce the products he claimed to be able to produce.

He just did it in China and not Taiwan.

Is that such a big deal? Potentially it's explosive.

China is not yet ready to deal with such nagging questions as human rights and worker exploitation. Workers are naturally paid less in China, South-East Asia, and the South Pacific than in Taiwan, but should still be able to expect basic human rights and to be free from abuse. Such is not always the case.

Consider this excerpt from a recent edition of the International Herald Tribune that gives background on a number of suits filed against major clothing companies found to buy clothing from factories in Saipan, a U.S. protectorate in Asia.

"...The suit says that in dozens of factories...workers are forced to work inhuman hours and to live in over-crowded and vermin-infested conditions. It even suggest that the workers are enduring a form of slavery, trapped in Saipan with impossible debts and with little freedom to leave."¹

Of note is that the factory bosses were not the ones who suffered the most from the report. They were able to keep importing unskilled and underpaid labor from China and exporting garments: They simply switched the labels from "Made in USA" to "Made in the Northern Mariana Islands, USA". The real victims were the vendors who sold the garments—including the Gap, Tommy Hilfiger, and Sears—who were faced with very tangible costs involved in a lawsuit and the very intangible costs of a public

relations

nightmare.²

Further consider the plight of Darin Latlakorn of Thailand, age 15, who considers herself lucky to have a job in a sweatshop where she makes US\$2 per a nine-hour day and where, twice, the needles of her sewing machine have punched right through her hands.³ Without proper due diligence, how does your company know Darin is not making your next order?

Even companies that conduct proper due diligence, and that go so far as to invest in a factory and monitor the operations periodically, are not immune to labor irregularities and human-rights abuses. Adidas and Nike come to mind as two socially conscious companies that learned to their chagrin their factories were employing child or prison labor without their knowledge.

Asia presents a different set of problems for buyers. A prosperous country like Taiwan, where the per capita income is greater than in the United States, is less than two hours by plane from the grinding poverty of the Philippines and Indonesia. Company owners are often tempted to accept orders in Taiwan and have the products manufactured overseas where labor is 30 times cheaper, land is practically given rent free, and tax holidays await the investors. Hong Kong, the great Asian monument to capitalism and the free flow of capital, is a train ride away from Third World working conditions in China.

The Perils of the Ostrich Approach

These unique problems give rise to moral dilemmas for associated companies in the developed world.

Some companies will opt for the ostrich approach: After all, the major retailer in England doesn't really need to know where the stereos come from. And even if it does, if the products are being made in conformance with local labor laws, what right does the retailer have to assert its values on Asian workers?

Other companies will try to guarantee that workers are employed not only legally but ethically, ensuring they are paid proper wages and that their ages can be verified before putting them to work in safe working habitats. This approach works as long as the parent keeps a presence on the factory floor, because once the factory goes unmonitored, the prime jobs often become the best commodity in a village and are bartered and handed out in exchange for kickbacks or other favors. The good jobs may even have a destabilizing effect on the local economy, as abnormal wages paid by well-meaning companies at times attract symbiotic service industries that do not develop the local economy but which siphon workers away from more productive but lower paying jobs in an attempt to service the well-paid workers.

Finally, a prospective buyer can come to Asia, vet the potential factories, hire trusted management to run the operations, and maintain an actual presence in the country. This approach works for companies who want to purchase a steady supply of products from local manufacturers for the foreseeable future, but is ill-suited for the company that wants to purchase one shipment of goods or is not intent on settling down in Asia. This is particularly bad for companies that wish to take advantage of e-commerce, which can arrange for a container of products to be delivered in the shortest possible time without ever having to leave the home office.

No matter what approach your company uses in dealing with overseas suppliers, be aware that the potential damage is not always measured in legal terms. Negative media and bad publicity is a real and expensive threat to your company, and can result in the loss of competitive advantage.

So at the dawn of the 21st century we find ourselves back at square one. Ten years ago, when looking for a supplier in Asia, the consumer had one option—get on a plane and go check the supplier out for himself. Now, thanks to the gods of technology, all business can be done from the comforts of home. Technological developments, especially e-commerce, have made it possible for every buyer in Europe or the United States to have access to the same suppliers as the major multinationals. All these wonderful developments, and now someone wants to come along and tell you that it's not worth the risk?

That's not my point at all. What I've tried to do is lay out the worst possible scenario, and as competitive intelligence professionals, you should be aware of the worst possible scenario.

Not that your sourcing strategy ever has to degenerate to the worst possible scenario. There are ways to protect yourself, even from abroad:

- Proper due diligence must be conducted. You would investigate your domestic business partners, so why not your overseas partners? Due diligence in Asia should, however, be done on a more thorough level, including researching the company's debt history and verification of hard assets. Some effort must be made to verify the company has the equipment, personnel, and time to produce your orders. Otherwise, it's possible the company will lead your order through an endless maze of subcontractors, some of which might not conform to the high standards you expect.
- Contact should be initiated with the potential supplier's customers -- and its own suppliers. If a supplier says it can product your order in 30 days, does it mean 40 days is close enough?
- Unannounced, pretext visits must be made -- but NOT BY YOU. If you can read

this in English, you will probably stand out in an Asian crowd, and if you visit a factory, you will not see things the way they really are; you will see what the principal want you to see. Visits must be made periodically by local people. If you have a branch near your potential associate, ask a local worker to visit for you. If you don't have a branch in Asia, find professionals you can trust.

- The partners' reputation in the media should not be ignored. Most Western companies are keen to the role the media plays in business, and few things sting like being criticized in the press. Find a market researcher or hire a consultant, but learn what the local newspapers are saying about your potential partner.
- Finally, remember Ignorance Is No Excuse. When in doubt, imagine how your CEO will look with a microphone in his face explaining that he really didn't know the soccer balls were being made by nine year olds chained to sewing machines.

The steps described above are not extraordinary. In fact, you are probably doing them already with partners in your home country.

Keep in mind, however, the stakes are higher here. If you did not perform proper due diligence on your subcontracted factory in Alabama, there is still little chance that it is employing prison or child labor. But that chance increases as you cross the International Date Line.

Luckily, proper vetting of potential suppliers worldwide falls in the realm of common sense and good business practice.

Does it fall into the realm of competitive intelligence? It does in the hands of your competition!

Notes

1. International Herald Tribune (February 22, 1999), "For Saipan's Laborers, Exploitation or Opportunity?" by Seth Faison, New York Times Service, p.2.
2. *ibid.*
3. International Herald Tribune (June 16, 1998), "In the Asian Crisis, Even a Sweatshop Job Beats No Job at All," by Nicholas D. Kristof, New York Times Service.