



## KEEP OPERATIONS STRONG AMIDST GLOBAL CHALLENGES

Kevin Lehrer & Jonathan Allen | Managing Partners | 5 Horizons Group  
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Without question, the consumer goods industry has been whacked by an economic chill on both sides of the ocean. In the United States, declining sales, inventory cut-backs, and limited credit are affecting demand at an exponential rate. Meanwhile, in China, the decline in exports has caused significant instability, widespread factory closures, and a growing unrest among a labor force that has lost millions of jobs over the past year.

Meanwhile, there is the U.S. entrepreneur/small-business/not-so-small business fighting to keep its sales moving forward, while keeping operating costs to a minimum. The challenge, however, is that in pursuit of minimizing costs, companies of all sizes expose themselves to a potential breakdown in their production and/or supply-chain (aka Operations). The consequences of such breakdowns include (1) miscommunication and strained relations with suppliers; (2) production delays; (3) inconsistent or reduced quality; and (4) over-paying for freight.

Reducing costs and maintaining a viable operation are not mutually exclusive interests. In fact, companies should view the economic turbulence as an opportunity to re-visit their operations, both in China and in the U.S. In doing so, we suggest considering one or more of these five approaches to keeping operations in-tact while being mindful of the economic realities:

1. **Revisit Product Costs:** Reach out to your suppliers and review product costs. While not all suppliers will provide them, we find that Bill of Materials (BOMs) are one of the best ways to discover opportunities to improve costing. That said, the single biggest mistake we see U.S. companies make in negotiating costs is doing so in an adversarial manner. The supplier is your partner and these discussions require a partnership mentality. The goal should be to improve transparency so that discussions can take place within a context of real data.
2. **Modify Payment Terms:** If product pricing is non-negotiable, pursue better terms. Typically, most U.S./China relationships begin using a Letter of Credit (L/C) as the mechanism for payment and protection. L/Cs are costly and cumbersome, so as time goes on and trust develops, many companies are successful in negotiating terms that include a deposit upon issuing the Purchase Order, and then a balance payment upon completion of production. This process is cheaper and helps to free up your borrowing base – which is particularly useful given current economic conditions. Additionally, consider asking your factory to extend the time that your balance payment is due). Recently, we have had clients successfully negotiate terms of up to Net 90 days. In these times, if you have reasonably stable orders, it's a buyer's market.

SAINT LOUIS, MISSOURI (USA) | DONGGUAN CITY, GUANGDONG (CHINA)

314.272.4366 OFFICE | INFO@5HORIZONSGROUP.COM | WWW.5HORIZONSGROUP.COM

- 3. Inspect, Inspect, Inspect:** The single biggest “operations cost killer” is the scenario where the shipment of Red and Blue Widgets arrive at the U.S. warehouse, and the warehouse manager opens up the first box to find that that Red Widgets are in the box marked “Blue Widgets”. What happens now is a series of events that include long-nights checking and repackaging every box, over-time expenses, and a general morale drain.

And yet, for a fraction of the cost of this “all-night repackage-palooza” you could have hired a service to inspect the product and packaging at the factory before it shipped. If you do choose to hire a 3<sup>rd</sup> Party inspection company, make sure that you hire them well before the product is going to ship so that there is time to review product standards, potential production variances, thresholds, etc. Do not hire a company to inspect your product “site unseen” – there is not enough context for them to do the type of job you deserve.

- 4. Stay in Contact with your Suppliers:** Remember, the issues facing the consumer product industry are global problems. It is probable that your supplier is facing an array of issues that you are not even aware of. The last thing that you want to happen is to find out that your factory shut down overnight or has to postpone your production. This is not to say that there is any full-proof plan for preventing this from happening. However, the more communication you maintain on a regular basis – either directly or through the use of a trusted agent – the more likely you are to avoid costly surprises.
- 5. Improve your Freight Costs – immediately:** If there is a silver lining in this economic storm, it’s that many companies, while taking a hit on top-line sales, are keeping their bottom-line afloat by improving transport costs. A combination of reduced exports and the decline of oil prices have SIGNIFICANTLY reduced the costs of ocean containers. If your freight costs are rolled into the price you are paying your factory, and those costs are the same as you were paying in early-to-mid 2008, request an immediate understanding of the freight component from your factory. If your freight pricing is separate and you use a freight forwarder, be sure to request an updated quotation.

5 Horizons Group, LLC provides consumer product companies with turn-key solutions ***From Source to Shelf***. With offices in the United States and China, 5H’s mission is to provide every client with the tools and resources necessary to create a comprehensive, profitable, and sustainable Asia-Western business model.