Procurement from CEE Countries:
Expectations of French companies and feedback

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Abstract:
While many studies focus on sourcing from Asia, there is a net deficit of literature on supplies made from Central and Eastern Europe (CEE). This finding led us to carry out research on the subject. We conducted a survey of 324 European companies, mainly French, of various sizes and sectors. Our results show that the seek for reduced costs is the main reason for sourcing from CEE, but that reactivity concerns are very real, and that the imitation effect also seems confirmed. It appears also that some firms are beginning to relocate some supplies from Asia to CEE.

Keywords: procurement, sourcing, Central and Eastern Europe

Recent studies show a number of questions about the future of sourcing from China, which is still the main source of low-cost supply of French companies: According to research conducted by Cariou and Dornier (2012), the balance of power between Chinese suppliers and French buyers appears to have been reversed since 2009 to the point that "for some companies, the question is no longer how to negotiate the best price, but how to find a supplier that accepts to deliver in time products meeting our quality requirements". Several U.S. studies establish the same conclusion (Sirkin et al, 2011).

According to Cariou and Dornier, so there are two alternatives: strengthening old relationships with some Chinese suppliers (only large companies can afford such an investment), or finding new areas of sourcing, taking into account not only labor costs, but also "professional skills, the quality of the supply chain, the ease of doing business (timeliness delivery, language or cultural barriers) and finally ethics." On all these points, it seems to us that CEE countries are a real alternative to Chinese supplies, at least for certain products or services: According to a recent study by Jensen and Pedersen (2011) on Danish companies, CEE mainly attracts production activities and IS, but of a less advanced level than the activities usually relocated in Asia.

This paper is organized as follows: we present the literature related to the benefits of supplies from CEE, before explaining our research methodology, and presenting our results and conclusions.

The characteristics of Central and Eastern European supplying markets
Though CEE is, after China, the second geographical area of low-cost supplies of French firms (Deloitte, 2007), the literature on offshoring regarding these countries is very scarce, unlike the literature on Chinese and Indian supplies. Only a few European articles (Marin et al, 2003. Marin, 2004, 2006, Safar, 2006; Kinkel, 2012) specifically
analyze the advantages and disadvantages of supplies from this area for European companies. This is why we will not only use their results, but also empirical results obtained by consulting companies to analyze the pros of supplies from CEE, moreover research combining theoretical and empirical analysis approach are infrequent (Jensen and Pedersen, 2011).

The pros of supplies from Central and Eastern Europe
Safar (2006) clearly explains the emergence of Central Europe and Eastern Europe in the globalization and offshoring process. The author starts with the observation of the development of offshoring in the 1990s. In CEE countries, the years 1990-1998 mark a period of transition to a market economy, while the 1998-2000 period sees the beginning of offshoring to this area by Western companies. To the difficult years 2001-2002, caused by the bursting of the Internet bubble follows "the-world-opportunities-years" (2003-2004). Many countries in the region join the European Union, leading to large outsourcing flows. Since 2006, CEE countries have entered a phase of maturity, easing administrative procedures for supplies from CEE countries.

- Costs
Since 2004, AT Kearney has been publishing an annual index of financial attractiveness of different countries of the world, based on labor costs, infrastructure costs (rent, energy, transportation costs), and finally taxation costs and other regulatory elements (perceived level of corruption, appreciation or depreciation of local currencies). The index published in 2011 (AT Kearney, 2011) shows that the countries of CEE are certainly far behind Vietnam and Indonesia, but some of them (Ukraine, with an index of 7.14, and Bulgaria, with an index of 7.05) are better ranked than China (6.55). Overall, CEE countries are attractive and ranked in the following order: Romania (6.35), Russia (6.19), Slovakia (5.82), Poland (5.35), Hungary (5.11), Turkey (4.68), Czech Republic (4.53). As a comparison, the index of France is only 0.95.
In addition, travel costs of French managers to meet or audit their local suppliers, rarely calculated, are lower than the costs generated by travels in Asia. Overall then, the cost of imported products from CEE is in many cases similar to the cost of Chinese products (Juan et al., 2010).

- The availability of skilled workers
The second criterion considered by AT Kearney to assess the attractiveness of a country is the local availability of skilled workers. This scale which takes into account (beyond the level of education and experience) the large number of workers in the country, naturally favors countries with large populations like India (9.2) or China (8.51), while much smaller CEE countries are middle ranked with scores around 4 except for Russia, which scores 6.
However, if we analyze in this index, the share devoted to education, small CEE countries are comparable to that of India (1.39) but present higher scores than China (1.33). Poland, the Czech Republic and Hungary get a score of 1.39. Russia and Turkey are slightly behind with scores of 1.29 and 1.20.
These findings are consistent with the assertions of Safar (2006) and BCG (Waddell et al., 2006), who state that much smaller CEE countries have experienced, motivated, productive and flexible workers with a good level of education. Finally, Gonzalez, Gasco and Lopis (2006) point out that CEE countries have cultural similarities with
Western Europe, good foreign language skills and a good level of technical expertise. Ernst & Young on Russia (E & Y, 2012) develop similar assertions. The availability of qualified personnel matters: it will make it easier to find local suppliers, but also to improve the quality of the products purchased, which as we know, is the second concern for companies when choosing the location of their supplies (Kinkel, 2012).

- **The business environment**

Finally, the third important criterion when choosing the location of supply sources concerns the local business environment, including country risk, local infrastructure, cultural differences and the risks related to counterfeiting and intellectual property (Farrell, 2005; Cariou and Dornier, 2012). According to the AT Kearney index on the business environment, most CEE countries, obtaining scores between 5.5 and 6.7, rank much higher than China (4.38). Only Russia and Ukraine seem to offer a very bad environment, since they are at the bottom of ranking, just before Indonesia and Pakistan.

These results are not surprising, since the entry of some CEE countries into the European Union has led to lower level of corruption, and facilitated trade with Western European countries, by simplifying them (Marin, 2006). For example, Poland spent 7.6% of its gross domestic product to improve public procurement procedures (Engelbrekt, 2011), usually regarded as key elements in the political, legal and administrative integrity of this country.

- **Responsiveness**

A key element in our view, not included in the Kearney world index, is the proximity of CEE countries with Western Europe: Kinkel & Maloca (2009) explain some failures of offshoring strategies to emerging countries by what they call large physical and cultural distance. Beyond cultural proximity already mentioned, the geographical proximity of CEE countries with France shortens the supply chain, and provides necessary responsiveness for some innovative products or services (Fisher, 1997). Thus, according to Fisher's model, a supply chain has a mediation role in the market: the role of synchronizing customer expectations and product characteristics, particularly in terms of cost and availability. Innovative products according to Fisher cannot be supplied from distant areas; the responsiveness of the supply chain should therefore be preferred for these products. On the opposite, supplies from CEE countries allow much of this responsiveness.

Finally, a recent study by Juan et al. (2010) among thirty multinational companies shows that these companies do not simply reason in terms of "countries with lower costs," but in terms of "better cost countries", including all costs related to procurement and mentioned above, and no longer only to purchasing costs. The question is now for companies according to the BCG study, to move away from the old model based on lower labor costs, so as to extend their sourcing to other countries, especially if willing to set up a responsive and agile supply chain.

Given these developments, and the lack of literature on the subject, we have questioned about the determinants and expectations of French companies that choose to perform all or part of their strategic supplies from countries in CEE, as well as their level of satisfaction.
**Research Methodology**

To answer these questions, we conducted a survey focusing on the following points:

- The characteristics of firms in terms of sector, size, turnover,...,
- The implementation of strategic supplies from countries with low production costs,
- More specifically, the implementation of supplies from CEE, and the reasons for these choices,
- The feedback on supplies from the countries of CEE, broken down per country. So as not to overload our questionnaire, the list of countries in our sample will be only include the countries that exported more than 1 billion Euros to France in 2011, respectively, in descending order:

- Russia (13.9 B€)
- Poland (6.9 B€)
- Turkey (6.1 B€)
- The Czech Republic (5.8 B€)
- Hungary (3.4 B€)
- Romania (3.2 B€)
- Slovakia (3 B€)
- Slovenia (1.3 B€)

We contacted thousands of buyers and purchasing managers in January 2013, through two social networks Viadeo and LinkedIn, and with the involvement of the CDAF (Main French Purchasers’ Association). We got 352 responses, of which 324 complete and exploitable responses; companies in the sample are located in France and Western Europe. Statistical analysis were performed with SPSS 17.0 and SPAD7 software to set up the principal component analysis.

**Sample Composition**

Our respondents belong to companies from all industries and services. It should be noted that the overwhelming majority of firms in the sample belong to the industrial sector (over 78%), against less than 22% in the service sector, unlike the usual weights of the secondary and tertiary sectors service in France; this is due in our view to a greater number of buyers in industrial enterprises than in business services, as well as to more mature procurement strategies in industries. Thus, although our sample cannot be considered statistically representative of French companies, it seems to be representative of companies really concerned by the procurement function.

We also came to the same observations in a previous research on purchases in low-cost countries, based on another sample of firms (Féland and Griette, 2012).

Our sample consists of 50% of managers and purchasing managers, 38% of buyers, 6% of supply chain or operation managers, and 2% of CEOs mostly from small companies. These respondents belong to companies (or subsidiaries) from various sizes located in France for 90% of them, or in any other Western European countries for the others.

Firms in our sample that perform strategic sourcing from low-cost countries are firstly supplied from China (73%), secondly from CEE (67%); other countries or geographical areas have a much lower role in French supplies.

**Supplies from Central and Eastern Europe**
Our research being focused on CEE, we then limited our sample to 150 companies that carry out strategic supplies from this region. Among them 71% also supply from China, 34% from India and 32% from other low cost Asian countries; globally 79% supply from at least one emerging country in Asia, which means that our respondents have a real vision of the pros and cons of sourcing from the CEE countries compared to Asian supplies.

**The duration of sourcing from Central and Eastern Europe**

Our results show that CEE is not the geographical area towards which French companies turned first for their strategic sourcing from low cost countries. It seems that the French companies who started the movement there more than 10 years, also turned to the CEE as well as to other low-cost countries, however, those who took the plunge between 2002 and 2007 turned more to other geographical areas than CEE. We now note that the movement tends to reverse, since the percentage of companies that have started sourcing in CEE since 5 years is higher than the percentage of firms engaging for the first time on the LCC market. A clear signal of "catching up" in the sense that companies present in the LCC markets for a longer time now start to supply from CEE countries.

**The emergence of "nearshoring"**

Further on, our results show that some companies are now beginning to relocate their Asian supplies to Europe: 15% of our respondents now making strategic supplies from CEE transferred them from LCC Asian countries. These relocations were mainly done at the expense of China (74%), but also of India (30%), other Asian countries with lower costs (26%), and other non-Asian low-cost countries (26%). The main reasons are the lack of responsiveness of the supply from these regions (74%), involving high transportation costs (52%) and the need to have large inventories (52%). Poor quality is also far from insignificant since they occur in nearly 50% of the cases of relocation of supplies. Finally, in more than one third of cases, the current rise in labor costs in Asia, which reduces the cost differential with CEE countries leads companies to source in this last region.

**The Determinants of strategic supplies from the CEE countries**

Reasons given by our respondents who perform strategic supplies from CEE refer primarily to low-cost products and services; this motivation is described as essential or very important by 95% of companies. This result confirms the results of all previous studies (Sleuwaegen and Pennings, 2000; Maloca and Kinkel, 2009; Kinkel, 2012), indicating that the primary motivation for offshoring of companies is seeking lower costs.

However, responsiveness concerns play a very important role in the motivation of companies sourcing in CEE, as appears to be essential or very important to three quarters of the firms in the sample. Similarly, 64% of our respondents choose to source from this region because they benefit from better communication than with Asian suppliers.

It is interesting to note that the fourth motivation mentioned by our respondents is the significance of "not getting left behind by competitors already sourcing from this geographical area"; we have used this issue to try to determine the imitation effect described by Moatti (2008). Thus, according to a major literature review conducted by
Lieberman and Asaba (2006), the effect of imitation is motivated by two reasons often acting simultaneously: on the one hand, theories based on information highlight that pioneer enterprises are considered as holders of better information, which in turn motivates others to follow while neglecting their own information (Bikhchandani, Hirshleifer and Welch, 1992). On the other hand, theories of competition, especially from the field of strategy (Fiegenbaum and Thomas, 1995; Garcia-Pont and Nohria, 2002) argue that firms tend to imitate others to maintain a competitiveness balance. This imitation effect seems to be true for almost 60% of firms in the sample. 29% of respondents said it was "important" and 29% "very important" not to fall behind the competition.

Finally, quality concerns relate to a little more than half of the sample. In contrast, less than a quarter of our sample turns to the countries of CEE in order to acquire goods or services of unavailable technology elsewhere. Unlike other areas in the world, CEE countries do not seem to have unique expertise centers in the world.

The broad determinants of offshoring to Central and Eastern Europe

Beyond this unvaried reading of results, we sought to understand the key factors that drive companies sourcing in CEE, knowing that the proposed variables can be linked together.

We therefore performed a principal component analysis (PCA), after recoding our variables, assigning scores to their different modalities ("1" for "little or no importance" to "2" for "large enough", "3" to "very important", and "4" for "important"). It should be noted that we have excluded from our database the variable "customer demand", which only concerned companies operating in B to B, and therefore could distort the analysis.

Since the objective of a PCA is to reduce the number of dimensions in a database to summarize key information on a limited number of factors, we chose to focus our analysis on the first three factors, more significant than the mean (their eigenvalue is greater than 1, in accordance with the Kaiser criterion). Following this reduction, we can explain a total of 67% of firm behavior.

- Interpretation of factors

The first factor, which alone accounts for over 36% of behavior difference between companies can be described as quality concern, broadly defined, as the importance given by companies to product quality (-0.85), the standard of training of local staff (-0.79), suppliers’ responsiveness (-0.69), the quality of communication with them (-0.58) and, to a some lesser extend, the technology of supplied products.

The second factor can be understood as the search for lower costs (-0.75), the third factor representing meanwhile the imitation effect (0.86).

Thus, the first three factors explaining sourcing decisions from CEE are respectively the search for quality in broad sense, the search for lower costs and the imitation effect. It may seem surprising on first reading, that the first factor may not be related with the search for lower costs, while it is the main motivation for companies, as seen above: this is due to the fact that this variable is precisely not very discriminating in sourcing decisions from the CEE since important for all our respondents.

To determine the different classes of business, so we conducted an ascending hierarchical classification according to Ward criterion, choosing a partition into four classes in the sample (Figures 1 and 2).
- Class 1, which represents 20.5% of the respondents, includes companies that have very high expectations in terms of technology and quality in broad sense (product quality, but also suppliers’ responsiveness and standard of local staff training), however, these companies do not give much importance to communication with local suppliers.
- Class 2, which includes 19% of the companies of our sample is made up of companies sourcing in CEE and mainly for cost reasons and imitation effect. Thus they give greater than the average importance to cost, and to failure to keep up with their competitors sourcing in this geographical area. However, they are only slightly sensitive to the suppliers’ reactivity.
- Class 3 consists of 36% of our respondents. Companies belonging to this class expect above all a true quality service - including product quality, responsiveness of suppliers, quality of communication with them, and a good standard of local staff training. Not seeking to imitate their competitors, they seem to have a more proactive than reactive strategy.
- Class 4 includes 24.5% of companies, rather large (variable used as illustrative variable), which have below average quality of service expectation, but neither looking for lower prices nor driven by imitation effect.

In conclusion, more than half of our sample (56.5%), ie classes 1 and 3, are sourcing in CEE for reasons linked to the quality of service in this area, when 19% primarily focus
on low-cost, so as not to fall behind competition. This conclusion is however to be nuanced, when we previously showed that 95% of companies in our sample consider seeking low cost as a major factor in their sourcing decision from the CEE. Our results show that the search for low cost is the only determining factor for 19% of companies, when 56.5% attach to obtain both low cost and good quality service.

**Feedback from companies**

We asked our respondents to mention what they regarded as the strengths and weaknesses of the eight countries analyzed; the possible choices were "low cost products", "quality of products", "suppliers’ responsiveness", ease of communication with suppliers", "and "the existence of unexpected additional costs". We then analyzed responses (percentage of companies sourcing in the country) and conducted a principal component analysis followed by an ascending hierarchical classification according to the criteria of Ward, which helped us divide our sample into 5 classes of countries with different characteristics.

Thus, we collect on the first factorial plan 85% of the variance, which seemed good enough at first.

The first factor can be defined as quality in the broad sense since it combines the following variables: "reactivity of suppliers" (0.95), "quality" (0.84), and "ease of communication with suppliers" (0.70); these variables being opposed to the "unexpected additional costs" variable (-0.77). We shall define this factor as representing the quality of products and service.

The second factor is mainly determined by the "low-cost" variable (0.95); so it will represent production costs and unexpected additional costs.

The first factorial plan, supplemented by ascending hierarchical classification, according to Ward's criterion and the choice of a partition into 5 classes of the sample shows the following result (Figure 3):

*Figure 3: F1-F2 Factorial Design*

It appears that the country that mainly differs from others is Russia characterized by a very poor quality of service; product quality and responsiveness of suppliers are much lower than in the seven other countries, while the difficulty of communication with suppliers, as well as the existence of many unexpected additional costs are much higher.
On this axis, Russia is in strong opposition to Slovakia and especially to the Czech Republic, where quality of service is considered much higher than in other countries in the sample, according to our respondents. Romania and Turkey are mainly characterized by low costs, away from the group made up of Hungary and Slovenia characterized by higher costs.

The analysis of Poland, very under-represented on this factorial plan, requires the interpretation of a third factor, statistically closely linked to product quality and unexpected costs. Indeed the position of Poland on the factorial plan determined by factors F1 and F3 shows a country characterized by the quality of its products, but also by the existence of many unforeseen costs.

**Future procurement strategies from Central and Eastern Europe**
Overall, 63% of our respondents are satisfied (55.6%) or very satisfied (7.4%) with their supply from CEE, against 25% who say they are somewhat dissatisfied and 12% very dissatisfied.

While 37% of respondents show more or less dissatisfaction, only 9% of respondents plan to reduce the share of their supplies from CEE in the future. Of these companies, 44% plan to relocate their supplies towards countries with lower costs than CEE, 44% say they want to relocate to Western Europe, and only 12% want to relocate to France.

At last, a very overwhelming majority of companies expect to maintain (49%) or increase (42%) their supplies from this region. For the latter, the intensification of sourcing from CEE will be done through further relocation of supplies usually sourced today from Western Europe (61%), and France (also 61%); the idea will also be to supply new products from the CEE (46%) and, to a lesser extent, to continue nearshoring strategies -supplies today made from far away for low cost countries should be repatriated to CEE (25% of cases).

**Conclusion**
Given the lack of literature on this topic, our research helped clarify the expectations of French companies sourcing from CEE countries: while almost all of the companies in our sample seek for lower costs, more than half of them also search for quality in a broad sense, that is to say, product and related services quality (suppliers' responsiveness, quality of communication with them, high level of training of local staff). We also pointed out that CEE is not an homogeneous area; countries studied have different characteristics in terms of price levels but also in terms of product quality and responsiveness of suppliers. Finally, we found that French companies are globally looking to continue to expand their sourcing from this region, mostly at the expense of Western Europe and especially France, although nearshoring strategies appear to be confirmed to a lesser extent.

The limits of our study lie in the global aspect of our research, which considers that business has homogeneous behavior, while expectations and experiences presumably vary according to size, as we showed in a previous research on international supplies (Fel and Griette, 2012). A further area of our research might very well include the size of the companies in this study…

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