Pinnacle Buzz

Welcome to the **new edition** of "**Pinnacle Buzz**"– a quarterly newsletter designed to keep you informed on the latest developments in strategic sourcing, procurement, macro-economic and key commodity trends with a special focus on *low cost countries*.

Thank you for your tremendous response and feedback to the previous edition of the buzz which is very much appreciated. In this edition, we have focussed on strategy tools for management. In addition there are articles on Indian Rupee, commodity outlook on Copper and China plus one strategy.

We greatly value your interests and opinion, and you have been identified as a key stakeholder. As such we have included you on our mailing list for this edition. If you do not want to continue receiving this quarterly newsletter then please send us an email with an unsubscribe note. We are also open to and shall very much appreciate your candid feedback.

I wish all the very best to you personally and professionally!

Yours Sincerely
Himanshu Kapoor
Managing Director

Inside the issue:

Rupee Depreciation – the Beginning or the End

The Indian Rupee has depreciated to an all time low with respect to the US Dollar in year 2013. On 28th August 2013, the Indian rupee had gone down to 68.825 against the Dollar. Though rupee has recovered partially to the levels of 62 in September after measures taken by new RBI governor, it is still down 11% from the 55 levels seen in December 2012.

But why the Rupee is depreciating?

There are domestic and global reasons for the rupee's free fall against the US dollar.

- Among domestic reasons are high current account deficit (CAD) and growth concerns.
- On the global front, the recovery in the US economy is expected to prompt the central bank there to end the loose monetary policy by the year end. Anticipating this, foreign investors are pulling out their money from India to invest it back in the US.
- Domestically, the Indian authorities firefighting did more damage to the rupee than salvaging it. While the government has opened up sectors for foreign direct investment, the RBI started tightening its monetary policy.
- RBI also brought in Capital flow measures by restricting how much Indian citizens and companies can invest abroad to reduce pressure on the rupee, while targeting the current account deficit by banning imports of gold coins and medallions among other measures.

Silver Lining

Importers of Indian goods are cherishing this fall which was reflected in India's August trade deficit which narrowed to a five month low as merchandise exports clocked double digit growth. A drop of 11% in Indian rupee to 62 levels from 55 in December 2012 provides them with an automatic margin of 11% - with no credit to them – on top of the regular profit margins thereby making India a lucrative sourcing destination.

Build purchasing team's capability to drive value

Many companies under invest in the purchasing team's capabilities and leave sourcing out of strategic decision-making processes in favor of functions such as manufacturing and sales, that drive revenues. Yet purchased materials and services make up to 60 to 80 percent of a company's total revenue.

As a result, companies that do not invest in their purchasing team's capabilities and culture are adding less value than their counterparts. According to a Mckinsey study on more than 500 companies around the world, organizations that employ leading-edge purchasing practices achieve almost double the margins of companies with below-average purchasing departments (20.2 percent versus 10.9 percent, respectively).

To convert the normal purchase routine into high performing strategic sourcing function, companies need to identify and build capabilities of their purchasing managers. This may include, but not limited to:

- **Analytical skills** such as ability to reverse engineer a supplier's cost structure (should cost analytics),
- to conduct a thorough supply-market analysis in different geographies around the globe that gives insights leading to a competitive advantage.
- **Leadership skills** such as the ability to navigate complex cross functional interests,
- to manage the trade-offs required to meet competing needs, and

- **Softer skills** such as communication skills, conflict resolution and negotiation, personal effectiveness, creative problem solving, strategic thinking and so on.
- ability to work with diverse teams, including influencing and persuasion skills.

Getting procurement right and building team capability can be very time consuming and also involves investment. Outsourcing procurement to specialist third parties is becoming an increasing popular solution. Companies that outsource their procurement function can tap into a pool of experts, who will be extremely results driven and delivering very specific KPIs. In addition, it will also be exposed to a constant stream of new ideas from experts that are well connected and much more aware of the latest procurement trends. This will result in the procurement function becoming more sophisticated and specialized.

Remember, **"The team with the best players wins" – Jack Welch**

Commodity Outlook: Copper

Copper ranks third in the world consumption of metals, after iron and aluminum. Global consumption of copper is expected to grow 3 percent y-o-y to 20.93 million tonnes in 2013.

According to International Copper Study Group, copper market is expected to have a production surplus for 2013 and 2014. Production of refined copper is expected to exceed demand by about 415,000 tonnes in 2013. This compares with a production deficit of 397,000 tonnes in 2012.

With stocks climbing and an even bigger surplus in 2014 of 681,000 tonnes, there may well be downward pressure on prices due to

- China, which accounts for 40% of world global consumption, is likely to grow slower at 7.4% in 2013 vs 7.8% in 2012.
- Lower pace of recovery in US and little room for optimism in EU.
- Uncertainty lingering in the market over tapering of the US Federal Reserve's massive bond buying program which will flush off liquidity and end the times of near zero interest rates.
- Lastly, substitution. With copper still 300 percent more expensive than aluminum, it has encouraged manufacturers to use other materials, notably aluminum, where possible.

Copper is in the vicinity of its weakest level in about two years on LME, trading at $3.30 per pound or $7250 per ton levels. While copper trades above its well perceived 'magic number' which is around $3 per pound, or $6,615 per ton, where we expect substantial support, should the current lack of confidence in the metals markets continue. For the remaining part of the calendar year, we expect the price to stabilize at current levels with a downward bias.

China plus One strategy

In today's fast changing global economy the best companies sense shifting macros before those changes transform the economy. And they respond creatively and quickly to shifts. Since last two decades, China was viewed as the global sourcing hub. But the scenario is changing.

Wage increases in China by as high as 30%: Wage increases in China have been driven by many factors. First, government policies have increasingly favored local workers and there right, which is part of government's economic stimulus strategy. Second is the shortage of skilled workers in eastern China, where the majority of manufacturing takes place. And third, increasing education levels among younger workers.

An appreciating Yuan: China currency has appreciated more than 34% since 2005 and 1.8% this year. A rising Yuan has reshaped the export business in China, the world's largest exporter. As the currency appreciated at an annual pace of 4 percent, some export companies with a low profit margin of less than 10 percent were forced out of business.

The above factors are among those changing macros that have started hurting the bottom lines of companies.

The way forward….

MNCs that currently outsource largely to manufacturers in China have to adopt China plus one strategy. It's seen as a hedge against China's rapidly rising costs or just diversification and not putting all eggs in the same basket. LCCs such as India, Vietnam, Thailand, Malaysia and Indonesia may become increasingly attractive as alternative sources for global production, due to low cost labor and depreciating / stable currency. These economies may not be as big a market as China but have specific areas of competence and expertise.

In Thailand

*It gives us immense pleasure to share that **Pinnacle Sourcing & Consultancy has added Thailand to its presence in ASEAN region** with the addition of a full time resource located in Chonburi. Our resource comes from manufacturing industry background and has good exposure to Operations, Business Development & Supply Chain functions.*

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