



# Global sourcing

Steve Blanco  
VP, Operational Excellence  
Electrical Group

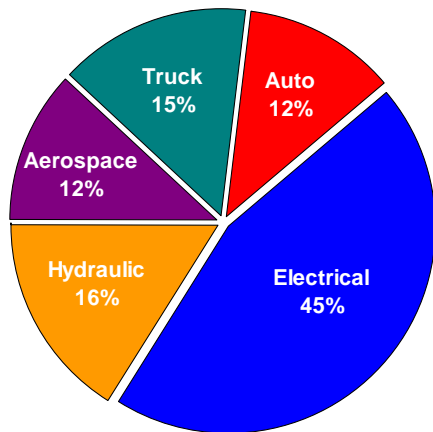


# Who is Eaton?

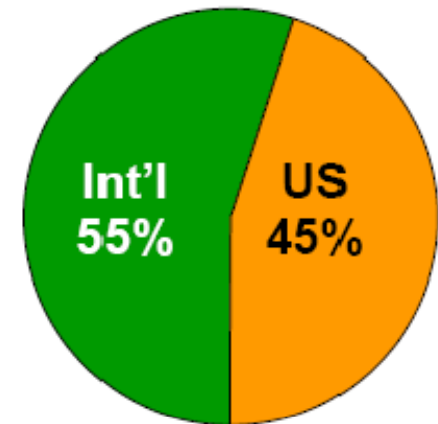
2008 Sales- \$15.4 Billion

Eaton is a power management company helping customers to utilize **electrical**, **hydraulic** and **mechanical** power more safely, effectively and efficiently.

By Segment



By Destination



# Global Sourcing ---Agenda

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- Supply chain priority
- Considerations in sourcing globally
  - Strategy alignment
  - Commodity analysis
  - Total landed cost
  - Risks
- Savings approach
- Examples

# Supply Chain priority-

- In the past 5- 10 years... companies have accelerated Global Sourcing.... LCC...BCC...
- Companies established global sourcing goals to take advantage of the expected 15-30% savings from sourcing in “best cost countries”
- For Eaton.....
  - 2002 → 8%
  - 2007 → > 30%



Over \$1.5 Billion per year

# Results of best cost country sourcing

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*Results– big savings with some projects, unexpected challenges for others....*

## *Why the challenges?*

- Inconsistent Quality
- Demand Variation
- Obsolete Inventory:
  - Long pipelines of defective material when an issue is found
  - Design changes
- Added “hidden” costs of the global sourcing
- Cultural miscommunications

# Sourcing Considerations

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*Eaton's approach...*

# Sourcing Considerations- Strategy Alignment

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Aligning Strategies – Making the “Right” Sourcing Decision

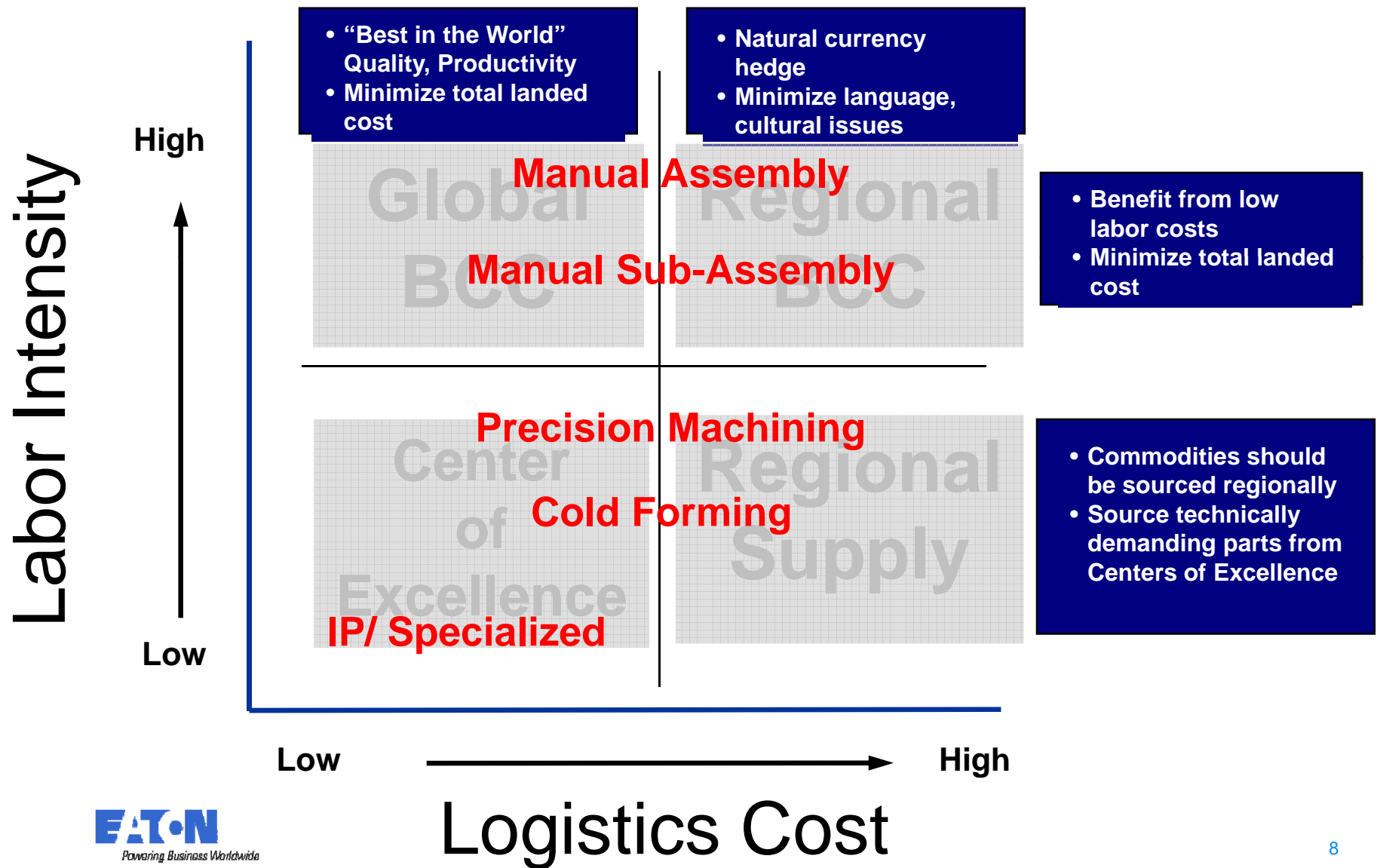


Business  
Strategy

Product Strategy

Manufacturing  
Strategy

# Sourcing Considerations- Commodity Analysis





# Sourcing Considerations- Total Landed Cost



## Piece price and tooling



## Exposure costs

- Cost of poor quality, containment actions
- Product changes
- Expedited freight

## Communication / support

- Supplier maintenance/ relationships
- Phone, travel, etc...



## Freight/ Transportation

- Duty and tariff
- Inventory carrying costs



# Sourcing Considerations - Risks

Such as...

**Economic risks**

**Natural Disasters**

**Energy costs**

**Raw material availability**



# The Approach- Evaluating the savings

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## Cost savings hurdle rate

- Identify a savings “hurdle rate” based on business requirements.
- Typical hurdle rates for Fortune 500 company exceed 20-25% ROI
- After all costs are included, is the project attractive at X% savings?
- Alternative investment factor must be inclusive of cost savings assessment
  - What other options are available?
  - Each sourcing decision will carry it's own “hurdle rates” on case-by-case basis

# The Approach- BCC Cost Savings Formula (Example %)

$$\underline{\underline{\text{Total Cost Saving} = \text{CP} - (\text{BPC} + \text{F} + \text{DT} + \text{CQ} + \text{CC} + \text{AC} + \text{RF})}}$$

CP = Current Price  
BPC = BCC Piece Cost  
F = Freight  
DT = Duties/Tariffs  
CQ = Cost of Quality  
CC = Carrying Cost  
AC = Administrative Cost  
RF = Risk Factor

CP  
-BPC  
+ 5%  
+ 5%  
+ 2%  
+ 1%  
+ 1%  
+ 5%

*All #'s are  
guidelines and  
need to be  
determined on a  
case-by-case  
basis*

= Total Cost Savings

If Total Cost Savings % > Hurdle Rate %  
Then Project is a "Go"

# Examples of applying the approach...

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## EXAMPLES

# BCC Cost Savings Formula (Example #1)

## Piece Cost

Domestic Supplier Cost	\$5.25
BCC Supplier Cost	<u>3.10</u>
Cost Savings	\$2.15
Initial Cost Savings %	41%

Old model would indicate project is a  
"Go"

## Total Cost

Domestic Supplier Cost	\$5.25
BCC Supplier Cost	<u>3.10</u>
Cost Savings	<b>\$2.15</b>

## **Premium Additions**

-Freight (5%)	0.16
-Duties(5%)	0.16
-Cost of Quality (2%)	0.06
-Carrying Cost (1%)	0.03
-Admin. Cost (1%)	0.03
-Risk Factor (5%)	<u>0.16</u>

**Total BCC Cost Premium \$0.60**

**Net BCC Cost Savings \$1.55**

**Cost Savings % 30%**

**Opportunity Cost Hurdle Rate 15%**

**This new model would also indicate a "Go"  
as the cost savings of 30% has exceeded the  
15% hurdle rate set for this project / commodity.**

# BCC Cost Savings Formula (Example #2)

## Piece Cost

Domestic Supplier Cost	\$5.25
BCC Supplier Cost	<u>4.10</u>
Cost Savings	\$1.15
Initial Cost Savings %	22%

**Old model would indicate project  
is a “Go”**

## Total Cost

Domestic Supplier Cost	\$5.25
BCC Supplier Cost	<u>4.10</u>
Cost Savings	<b>\$1.15</b>
<b>Premium Additions</b>	
-Freight (5%)	0.21
-Duties(5%)	0.21
-Cost of Quality (2%)	0.08
-Carrying Cost (1%)	0.04
-Admin. Cost (1%)	0.04
-Risk Factor (5%)	<u>0.21</u>
<b>Total BCC Cost Premium</b>	<b>\$0.79</b>
<b>Net BCC Cost Savings</b>	<b>\$0.36</b>
<b>Cost Savings %</b>	<u><b>7%</b></u>
<b>Opportunity Cost Hurdle Rate</b>	<b>15%</b>

**This new model would indicate a “No-Go”  
as the cost savings of 7% does not exceed the  
15% hurdle rate required for this project / commodity.**

# Summary

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- Support your Supply Chain priorities by maximizing the value of global sourcing...
  - Strategy Alignment
  - Commodity Analysis
  - Total costs
  - Risks
- Conditions change- have an approach flexible enough to account for new horizon issues.
- Effective sourcing considerations can enable an organization to fully understand the true impact of their decisions.



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*Powering Business Worldwide*