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**Trust and Contract – Sharing the Same Purpose –
-- Overseas Procurement –**

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Introduction

Kinki Sharyo made its first efforts to procure parts locally in an overseas project in connection with the manufacture of electric trains for the Cairo 1st Subway Line in Egypt, which was entrusted to the company in 1992. (Similar efforts that we had made in earlier U.S. projects, under the provisions of the Buy American Law, are excluded from the scope of this consideration.) In the Cairo project, we were demanded to manufacture some vehicles as a reinforcement of others already delivered by a competing overseas manufacturer. Accordingly, only a small range of parts required for coordination with existing vehicles were procured overseas, and an overwhelming proportion of parts had been manufactured in Japan. Also, local procurement was executed mostly through the mediation of a trading firm that represented a main contractual party. Therefore, the situation was somewhat different from a full-fledged overseas procurement.

Our first full-scale overseas procurement was executed for a project to manufacture double-decker passenger trains for KCRC in Hong Kong, which we won in 1995. In this project, the customer demanded us to apply an overseas standard to vehicles. Also, Swiss-made locomotives were to be used to haul trains manufactured by us. These circumstances gave rise to a need to use many mechanical and electric parts made to overseas standards. Accordingly, a large number of subsystems and parts had to be procured overseas, forcing us to contract directly with overseas manufacturers for procurement.

Subsequently, overseas standards were applied to commuter trains delivered to KCRC in Hong Kong in a project won in 1999, and trains delivered to the Transportation Bureau of Dubai in a project won in 2005. Thus, overseas procurement has been continually practiced to procure parts that are not available in Japan, and/or to reduce costs by using products meeting overseas standards. On the other hand, Japanese standards are applied to vehicles manufactured for domestic users. Also, main systems are mostly procured directly by users, and provided by them to vehicle manufacturers. As in the past, therefore, overseas procurement is practiced only in projects involving the export of vehicles, barring a small number of exceptions.

Differences Between Overseas and Domestic Procurements

People often say that overseas procurement is a strenuous task, because it is totally different from domestic

procurement. However, it would be incorrect to attribute difficulties of overseas procurement to such differences. Rather, the difficulties stem from the fact that in domestic procurement, many matters that would have to be checked by the parties of a purchase contract in an overseas project can be resolved through tacit understandings between these parties, because of the longstanding partnership between a customer and a supplier, as well as of shared commercial customs, language and culture. Important differences between overseas and domestic procurements boil down to matters that are not applicable to domestic procurement, such as those related to exchange rate, and the need to comply with a local customs law and rules on plant quarantine when exporting articles to an object area. Therefore, this chapter will introduce part of business that requires much more attention in overseas procurement than in domestic procurement.

Understanding of the Contents of Contractual Documents from the Customer

A vehicle export project involving international bidding entails overseas procurement not only for the manufacturer that has won the project, but also for the owner of the project (i.e. the customer). Since the name, the country and other details of the winner of the project are unknown at the start of the bidding process, contractual documents from the customer include its demands regarding highly detailed aspects of the project. Such minutiae may involve some risks for the winner of the project.

Potentially risky details include e.g. the responsibility to provide exchange parts over a long period of time, equivalent to the service life of vehicles; and the obligation to disclose software and other details of intellectual properties that are required to maintain vehicles over several decades. As it is impossible for our company to cope with risks involved in such obligation solely on its own, this burden need be shared by suppliers of subsystems and parts used for vehicles. Therefore, the correct understanding of the contents of contractual documents from the customer is highly important in dealing with overseas procurement in a vehicle export project. Also, the customer may make special demands, e.g. when there are some restrictions on parts suppliers or individuals involved in the project due to the political situation or religion of the customer's country. In such a case, special care must be taken when selecting the suppliers of vehicle parts, in addition to evaluating their technical abilities and pricings. It may also be necessary to request parts suppliers to be careful about similar matters to

avoid unexpected frictions with the customer regarding the manufacture or delivery of vehicles.

Concluding Contracts with Vehicle Parts Suppliers in an Overseas Project

After winning a project, a manufacturer must contract with suppliers regarding the provision of subsystems and parts for vehicles. As in a domestic project, this business includes the mutual check of prices, delivery schedules and specifications. In an overseas project, additional work is required to reach detailed agreements on contractual matters, such as delivery conditions, cancellation, acts of God, disputes and applicable laws; and conclude a contract incorporating these agreements before placing orders with a supplier. It takes much time and labor to have this contract concluded. In some cases, a legal specialist from the supplier gets involved in negotiations, which may prolong this process to unending rounds of discussion. Such a situation results from a struggle between a vehicle manufacturer like ours which considers the largest possible proportion of risks that may arise from its contract with the customer, shared by suppliers; and a supplier that tries to avoid such risks as far as possible.

Once our negotiators have managed to conclude a contract with a supplier, our staff in charge of materials and the supplier's sales staff must ensure that contractual obligations will be fulfilled in terms of the provision of products and services, to avoid situations in which provisions on violations of the contract must be applied. After placing an order with a supplier, it is therefore important to build up mutual trust in the process of the fulfillment of obligations. This mutual trust will help us shorten contract-related negotiations in future projects involving the supplier.

Conclusion

Overseas procurement at Kinki Sharyo already has a history of over 10 years. During this period, the spread of the Internet and other developments have been making the world increasingly "borderless." As a result, circumstances of overseas procurement have changed dramatically in the past few years. Also, a recent increase in the number of our export projects has turned overseas procurement into a rather routine business. However, various systems employed by our company for purchase and production still have many elements that are not adapted to overseas procurement, and mostly implemented through handwork. Accordingly, one of our future tasks is to redesign such systems to suit them to overseas procurement.