



Outsourcing: It's a Matter of Time

One of the great challenges to manufacturers is whether to make or buy a part or product. Determining the costs and benefits are often difficult. And there is a great deal of pressure to source products overseas to keep up with the competition.

Outsourcing is often justified on the basis of saving direct labor costs. But the typical manufacturing company incurs only 5 to 10% of its cost from direct labor and those savings are overcome by the cost of logistics to handle and transport the product. And since the cost of raw materials are virtually the same around the world, that only leaves overhead expense for potential savings.

Lean Math of Outsourcing

But in reality, companies often have to add overhead to source and maintain an overseas supply chain to order, expedite, and handle the shipments. James Womack in Lean Thinking sites 16 added costs in the “Lean Math” of outsourcing and there are undoubtedly more depending on the company and its experiences. These costs are often hidden in a company's overhead costs where they are not tied to the activities required to keep outsourced product flowing.

Recent incidents have shown significant problems in controlling conformance to prints and specifications from external suppliers. Changes to the product or process can occur without communication, leading to embarrassing product failures or even recalls. So the cost savings for overseas or outsourced parts and products must be substantial to overcome these expenses.

The Impact of Time

Beyond the hidden costs and loss of control, there is another consideration that is just as important: Time.

More specifically, can the proposed supply chain provide products, parts, services, and support as needed, every time, to meet the demands of the customer?

The supply chain must have the ability to alter deliveries to meet demand fluctuations from customers. If not, then any savings expected from outsourcing will evaporate due to expediting charges or, worse, lost business.

The longer the planning horizon, the more variability will exist in the supply chain. Since all forecasts are wrong, it becomes even harder to schedule exactly the right quantities and models at the right time. So if outsourcing creates a longer lead time, then the odds go up that the manufacturer will not have the right products when needed while the wrong ones fill warehouses.

Growth In Lead Times

A recent IBM/Industry Week survey noted that “29% of respondents said globalization has improved margins, but 37% said it also has increased lead times.” Do those respondents understand the impact of the increased lead times on the total costs of doing business? While margins are improving, what is happening to profit and cash after the impact of extended lead times?

The result is that the Make vs. Buy decision, which has always been difficult, has gotten even harder. There can be great rewards in outsourcing a key component or product to provide needed capacity, lower costs, and expertise with a key process. But there are also numerous pitfalls to steer around.

Not only do managers have to understand the true cost impact and loss of control but also, just as importantly, determine if the supply chain is able to consistently meet variable delivery demands. Manufacturers who understand the impact of time in outsourcing decisions place themselves in the best position for success.

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