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Your Shore or Mine?

Reconsidering the decision to outsource

Several years ago, it was almost fashionable to outsource to low-wage areas of the world to reduce costs. Business leaders developed the mind-set of “offshoring is always cheaper,” and they scarcely looked beyond unit cost plus transportation.

Fast-forward to 2008 and 2009, and witness the costly and embarrassing problems surrounding the discovery of lead in children’s toys, contaminated baby formula, and toxic drywall. Also consider recent oil price shocks and the earthquake and tsunami that severely disrupted supplies of many critical electronic and automotive parts in 2011. The US dollar has been on a downward path, making imports increasingly more expensive—and, on top of all this, wages in China are skyrocketing. Is it any wonder that company decision makers are taking another look at the costs of offshoring?

Re-shoring for profit

There is increased interest in bringing products back to US suppliers—or, re-shoring (also known as back-shoring or on-shoring). This movement is driven by the economic realities previously outlined, along with increased awareness of the inherent risks of long supply chains and a growing sense of unease over the decline of American manufacturing.

On the surface, offshoring seems like a no-brainer because the unit costs are so low. But unit cost is just the start. The most obvious additional costs are logistical: shipping and handling, import expenses, brokerage or agent fees, and more.

The hidden costs might be even more significant. For one, the lead time for sourcing a component from China likely will be measured in weeks or even months. Lot sizes must be large enough



to justify the logistics costs and to cover demand between shipments. Longer lead times also require larger forecasts and more safety stock to cover the risks of disruption. There also is less flexibility to respond to demand changes and higher risk of obsolescence. And if there is a quality problem with a batch, the impact is severe.

Next, consider the communication and management issues. There are language barrier and time zone differences to deal with. There also might be a need to send a representative to the supplier to check on processes and quality, or to negotiate terms.

Changes in labor expenses, transportation fees, and exchange rates are stirring reconsideration of offshoring decisions. Many business leaders are pleasantly surprised to discover how competitive domestic sources can be. North American suppliers have focused on higher-margin business with short lead times, low volumes, and high precision—but would welcome an opportunity to bring back some higher-volume work. And because labor is a relatively small portion of the cost

of goods, the higher productivity of Western plants can help lower overall expenses.

Of concern, however, are the issues of capacity and capability. Many companies reduced or even eliminated internal capability when they began outsourcing. Likewise, some domestic suppliers closed their doors after business migrated elsewhere; so, finding a domestic supplier with enough capacity might be challenging.

Internet-based exchanges, which link buyers to contract manufacturers, may help. One such trade exchange, MFG.com, recently rolled out a partnership with the state of New Hampshire to connect New Hampshire-based buyers and suppliers. The company is talking to other states about setting up similar arrangements.

Finally, consider that domestic sourcing is both lean and green. Long, complex supply chains violate many lean principles and contain non-value-added activities and delays. Shipping product halfway around the world consumes fossil fuels and generates pollutants, and it makes it much more difficult to

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monitor and control quality, content, and production conditions.

Whichever term you prefer—near-shoring, re-shoring, back-shoring, or on-shoring—there are many advantages to be found in bringing production home. And it is much more affordable today than it was just a few years ago.

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