



Manufacturing Process Outsourcing: Control without the Cost

WP2.1

Challenges of Today's Manufacturing

INDUSTRY WEEK recently conducted a survey asking several hundred U.S. manufacturers an open-ended question: What is the biggest challenge facing the manufacturing industry today? Most responses shared these revealing key words: "cost", "quality", "productivity", "supply chain", "inventory", "skilled labor", "logistics", "lean", "offshoring", and "China".¹

US manufacturers of all sizes must compete in the global marketplace where responsiveness and agility are necessary for survival. This is a challenging task, however, as they try to respond to market demands without sacrificing quality, workforce efficiency or lean inventory. Despite these challenges, there are ways to compete effectively without shifting production to an offshore firm. Imagine a solution that achieves cost reductions while maintaining quality levels, visibility, and control, and also allows you to just focus on critical manufacturing processes. This solution exists, and is called Manufacturing Process Outsourcing (MPO).

Solution: Manufacturing Process Outsourcing (MPO)

MPO is available today from Holland Group — an onsite outsourcing company specializing in the design, implementation, and operation of workforce solutions for manufacturing companies.

The MPO solution is a combination of workforce management (recruit, hire, train, manage, track, report) and productivity enhancement via process engineering and lean principles. This innovative alternative cuts costs while maintaining outstanding quality levels without traditional outsourcing supply chain issues. It is implemented inside your facility on non-core, labor intensive processes, allowing you to focus on activities that are of greatest strategic importance to your company. Holland Group is responsible for not only reducing your costs, but also increasing your throughput and improving quality.

The Dilemma Behind Hidden Costs

There is no question that offshore manufacturing operations can offer significant advantages. The industry-wide drive to reduce costs, expand into new geographic markets and focus on core processes are the reasons offshore outsourcing appears attractive. Before selecting offshore outsourcing however, it is important to understand the associated hidden costs. Offshore outsourcing can introduce new risks associated with a more complex supply chain, different quality standards, unplanned travel, currency fluctuations, and even political uncertainties. A recent AMR Research report found that 90% of the 200 companies surveyed confirmed they were outsourcing production, much of it off-shore. Of these, 56% admitted that their costs relative to prior sourcing had actually increased.² Some of the culprits cited in the 'hidden costs' were:

- **Transportation expenses** - Unplanned air freight and the rising cost of fuel suggests overseas sourcing can double a company's logistics expenses.
- **Quality issues** - The 'fatal costs' of poor quality is reflected in rework, recall administration, and lost sales.
- **Intellectual property loss** - Counterfeit products are pervasive as some overseas vendors work two shifts for its customer and then a "third shift" to produce "knock off" products.
- **Escalating inventory costs** - When outsourcing, manufacturers typically experience twice the inventory holding costs of in-sourced peers in order to manage potential shipment delays.

Supply chain specialists note that offshoring may result in lead times which are 3-4 times longer in order to manage supply and demand uncertainties as well as potential transportation delays and cost increases. The end result may be lower cost of goods sold (COGS), but a higher inventory level and lower levels of customer satisfaction.³ International transportation, on average, involves 27 different parties, substantially increasing the lead time unpredictability.⁴ (Figure 1)

Offshoring Increases Supply Chain Complexity

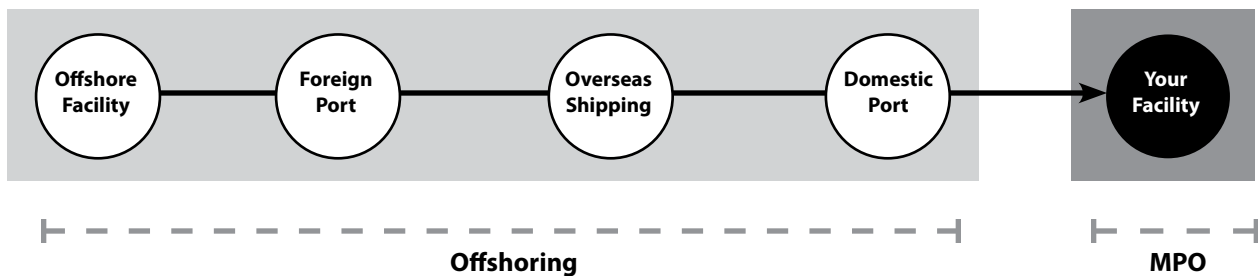


FIGURE 1 – Offshoring can dramatically elongate the supply chain, increasing costs and risks along each step of the way. Sourcing operations overseas also creates exposure to currency fluctuations and other unpredictable factors. MPO eliminates these hidden costs and risks altogether.

Quality has always been a concern for manufacturers. In 2007, quality issues repeatedly made international headlines, and 2007 was dubbed by the press as “the year of the China recall”. Products manufactured in China accounted for 67% of consumer product recalls announced in the US in 2007. The number of toy recalls in the US doubled from the previous year to 81 counts, of which 98% represented Chinese-made toys.⁵ On average, each recall costs about \$100,000, which is usually billed back to the manufacturer.⁶

Many manufacturers hire a trusted corporate representative to oversee foreign operations. Travel related expenses, temporary relocation and frequent corporate audits can add significantly to costs. Communications, transitioning work, lost efficiency, travel, and governance can add 12% to 57% to total costs.⁷

As manufacturers move farther away from home base, uncontrollable cultural, political, and currency risks can reduce the financial benefits of outsourcing. It may be difficult to quantify these effects, but according to a survey by BDO Seidman, CFO’s of many businesses cite currency risk (26%) and uncertain political/business climates (25%) as their main concerns regarding continued international growth in 2008.⁸

In response to hidden offshoring costs, many manufacturers are turning to other options for cost reduction. Temporary staffing immediately reduces labor costs as a whole by transforming fixed costs into variable costs. Many manufacturers experience peaks and troughs in work volume throughout the year. The general hiring rule of thumb for maximum cost-benefit under these circumstances is to hire enough full-time employees to handle the minimum work volume. Temporary workers have traditionally been used as a quick and cost effective means to fill the remaining positions of immediate need during times of high demand. Many manufacturers incorporate temporary workforce into their long-term planning efforts.⁹ However, this hiring strategy comes with several inherent disadvantages.

- The long-term use of a temporary workforce immediately puts a manufacturer at risk of co-employment litigation and unionization pressure. Applying temp-to-hire rules might alleviate some risks at the expense of diminishing some of the initial expected labor cost savings.
- Turnover rates may start to negatively impact performance and quality.
- The enduring effects of accumulated production know-how slowly dissipating through turnover are immeasurable, and a shortage of knowledgeable employees may result.

Most significantly, the business model of traditional staffing companies is at odds with the goals of a lean manufacturer. In fact, with a traditional temporary staffing business model, profits are realized by the vendor as headcount and man-hours increase. In other words, the more inefficient the process, the more man-hours required for completion; resulting in more profit for the vendors. In addition, manufacturers often discover that the reduced labor costs of temporary staffing are offset by the need for increased training and management. In an era where manufacturers are utilizing lean and efficient methodologies to drive down costs, this staffing business model is clearly counterproductive and prone to waste.

In order to maximize the benefits of staying on-shore (quality, control, and supply chain) and going off-shore (labor costs), manufacturers should consider the advantages provided by Manufacturing Process Outsourcing (MPO).

Manufacturing Process Outsourcing: A True Cost-Effective Solution

Manufacturers are now faced with the challenge of calculating the "soft" costs of offshore outsourcing; costs associated with monitoring vendor behavior, controlling quality, increasing inventory, and the impact of forecasting errors. Many of these costs are caused by the longer distances involved with offshore outsourcing and the lack of visibility once the process leaves the manufacturer's facility. MPO can eliminate this distance while retaining visibility, as all operations are implemented onsite. With MPO, manufacturers are leaving the management of a process to Holland Group, essentially outsourcing the entire function within their own plant.

Because everyone is under the same roof, visibility is well maintained and no additional inventory and transportation costs are incurred (Figure 1). Holland Group assumes full control of an entire process with its own semi-skilled full-time workforce. Holland Group's onsite supervisors and managers take responsibility for recruiting, hiring, training, managing, tracking, reporting, OSHA recordable, and safety measures. Production outputs are guaranteed to be delivered on-time at the quality standards set by the client. Furthermore, a detailed reporting structure is put in place to track and communicate safety, quality, production, cost, and worker metrics so that the clients have full visibility into all aspects of the process. As a result, manufacturers are able to keep costs at a minimum, maintain visibility and quality levels, and allocate resources and time to business-critical processes.

MPO extends lean manufacturing concepts to workforce management. MPO pricing is production-based rather than effort-based. Typically, clients pay "per-piece" instead of "per-man hour". The MPO model is aligned with manufacturing objectives; once a piece-price is agreed upon, Holland Group has the same incentive to control costs and increase workforce productivity as its client. Staffing vendors who charge per-headcount or per-man hour actually have the incentive to increase per-unit costs. In contrast MPO decreases labor costs, maintains superior quality, retains production knowledge, and avoids co-employment risks altogether. This approach also allows manufacturers to reassign their most talented employees to business's most important activities (Figure 2) while transferring responsibility for non-core areas to Holland Group, enhancing the overall operation.

This approach to onsite outsourcing has provided major Fortune 500 customers millions of dollars in cost savings. MPO allows total visibility by being onsite, guaranteeing production standards while improving processes. For one major automotive supplier, MPO was able to bring the following benefits:

Labor and Overhead Savings Greater than 40%

- Hourly, Salaried and Administrative Costs Decrease
- Improved Efficiency – Shift Elimination

Improved Quality - 50% Less Inventory Errors

- Improved Process Flow
- Drove Team Focus

Improved Delivery Schedule Attainment to 100%

- Six Sigma Process with Cross-Functional Team
- Training and Job Aids to Enhance Process Flow

Improved Safety - Reduced Frequency Rate by 53%

- Safety Team Drove Frequency Rate and Cost
- Transferred Client's Workers Comp Cost to Holland

FIGURE 3 – Comparison Table: MPO vs. Offshore Outsourcing vs. Temporary Staffing

	ADVANTAGES	DISADVANTAGES
Manufacturing Process Outsourcing	<ul style="list-style-type: none"> labor costs decrease short supply chain quality assurance managed and guaranteed productivity increases no labor turnover issues production know-how sustained no co-employment issues no political issues no currency issues 	<ul style="list-style-type: none"> inventory costs constant capital equipment costs constant
Temporary Staffing	<ul style="list-style-type: none"> labor costs decrease short supply chain no political issues no currency issues 	<ul style="list-style-type: none"> inventory costs constant productivity may decrease quality issues may increase turnover may increase production know-how may be lost potential co-employment issues
Offshore Outsourcing	<ul style="list-style-type: none"> labor costs decrease no labor turnover issues no co-employment issues productivity increases capital equipment expenses decline 	<ul style="list-style-type: none"> production know-how lost inventory costs may increase supply chain complexity/costs increase quality issues may increase potential political issues potential currency issues management and communications efforts increase significant start-up costs

MPO: an Ideal Solution for Lean Manufacturing

Numerous options exist today to attain cost reductions, but the real challenge is to be cost-effective without compromising quality, production knowledge, and efficiency. Holland Group has demonstrated that they can achieve these goals through MPO, allowing manufacturers to make strategic and thoughtful decisions for long-term growth.

To find out more about the MPO offering, please contact Holland Group or visit www.hollandgroup.com.

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About Holland Group

Holland Group brings the best practices of onsite outsourcing to manufacturing. Our clients enjoy the financial and operational advantages of outsourced manufacturing processes without conceding a significant amount of local control over day-to-day operations.

Using our proprietary methodology, Manufacturing Process Outsourcing (MPO), Holland Group takes full responsibility for a distinct manufacturing process, providing a skilled workforce of Holland employees that meets all production, quality and delivery goals and provides the continuous improvement needed to drive ongoing business growth.

We provide complete onsite management, supervision and operation of a specific assembly line, a given operation, or the entire plant. We revamp existing processes or create new ones. Many clients ask us to take responsibility for production in these four areas:

- **Packing**, including all related pick and pack operations
- **Material Flow**, addressing any of the inbound and outbound functions of the plant or warehouse
- **Pre-assembly and kitting** of product **sub-assemblies**
- **Test and rework** at critical stages in the production process

If you are interested in learning more about how Holland Group can help you, please visit us at www.hollandgroup.com.



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