

The Road to Contract Manufacturing Success

The chasm between outsourcing expectations and results can be wide. A new study sheds light on how manufacturers can close that gap.

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"Make vs. Buy" continues to be one of the most strategic decisions manufacturing companies can make in this day and age. Whether the motivations to outsource manufacturing are

bottom-line focused, capital driven, or intended to improve the top-line, discussions with many companies across a range of industries indicate that manufacturing outsourcing is often falling short of expectations. A recent A.T. Kearney survey sheds some light on why there is still a sizeable gap between strategic intent and operational execution and how that gap can be closed.

Outsourcing Manufacturing

Companies have been outsourcing their manufacturing operations for a variety of reasons and across the ebb and flow of the economy. In bad economic times, reasons quoted are often lowering costs, shifting from fixed costs to variable costs, or transitioning products that are end-of-life away from prime internal assets.

When the economic tide is turning, reduced capital investment needed to alleviate capacity constraints, less working capital needed, and increased flexibility are the main drivers for outsourcing. And when times are good and growth is on the strategic agenda, companies often turn to contract manufacturing to provide them with faster speed-to-market, quick access to new markets, and improved customer responsiveness. Increasingly, we even see companies leveraging

their contract manufacturers' design and development capabilities as well as their expertise in specialized manufacturing processes to jointly pursue process and even product innovation.

But as companies increase their use of contract manufacturers, they also become more dependent on these third parties to achieve strong supply chain performance, improve their cost position, and drive innovation. So the selection, contracting, and, especially, the ongoing management of the supplier relationship is becoming increasingly important. Our survey indicates that companies typically focus more on the up front aspects of outsourcing their manufacturing operations (for example, developing the strategic decision framework for evaluating the outsourcing option and for selecting the right suppliers).

The execution aspects of managing outsourcing, such as managing supplier relationships and developing the right organizational structure to manage the contract manufacturing base, are not as strong an area of focus. However, to maintain strong performance in supply chains with significant third-party involvement, it is imperative that companies turn managing contract manufacturers effectively and efficiently into a core competency.

What We're Doing Right

The A.T. Kearney survey shows that companies get many things right. They spend a lot of effort setting up their outsourcing strategy: 69 percent of respondents reported a well defined strategic approach to outsourcing that was followed consistently. An even greater majority (77 percent) reported that, over the years, they have developed deep insights into the supply market for relevant

manufacturing processes. Most companies also focus greatly on managing the most obvious pitfalls of contract manufacturing: More than three-quarters of respondents claim to have strong practices to manage product quality and protect their intellectual property.

On the opportunity side, our survey and client experiences indicate that most companies do not segment their contract manufacturing base effectively and do not distinguish how they manage relationships across their supplier spectrum. If supplier segmentation is practiced, it's usually done based on the size of the spend or triggered by a recent history of issues, as opposed to being based on short and long-term strategic value of contract manufacturers. Along the same lines, the approaches to performance management also don't differentiate between suppliers and focus primarily on the basics—cost, quality, and service. The degree of focus on performance of suppliers is also usually a function of size of spend and history of performance issues.

The operating model is not sufficiently distinguished by the criticality of the products or processes that are outsourced and the capabilities of the contract manufacturers, thus likely sub-optimizing the use of resources that are involved with managing the contract manufacturing base. Other areas that indicated some weaknesses were the lack of solid processes for transition to and integration of the contract manufacturers and the overall maturity of the part of the organization that handled contract manufacturing, with roughly half of the respondents rating themselves at the “emerging practice” stage. And even though a majority of companies in our survey (53 percent) indicated that they were open to supplier-driven innovation, they usually lacked a formalized process to integrate the innovation with their own R&D-driven efforts.

Leveraging Supplier Relationship Management

Those gaps indicate that Supplier Relationship Management (SRM), a concept that is increasingly applied by procurement departments of companies across industries, is under-leveraged when it comes to contract manufacturing suppliers. The key to successful management of supplier relationships is to understand the value each supplier brings to the short- and long-term success of the company. Suppliers are segmented based on that value and each segment is managed differently.

Supplier performance is managed, not just on the basics, but using additional metrics to monitor progress on all aspects of value that the supplier relationship is expected to generate. Leading companies don't just expect the contract manufacturers in their most

strategic segments to meet their needs. They work collaboratively and transparently to ensure that they are equipped to handle demand variations, have supply continuity plans in place, and are actively engaged in continuous improvement efforts and even in joint innovation initiatives. They create strong relationships with their strategic suppliers, for example, by having peer-to-peer relationships at multiple levels, sharing their overall strategic plans with those suppliers (to the extent it pertains to them), and expecting them to develop their own plans that align with those strategic plans.

Leading companies also use contracts to align the strategic contract manufacturers with the company's objectives, push them to bring new ideas, and hold them accountable for results by using options such as fee-at-risk and incentive-based pricing models. They put the onus on contract manufacturers to be innovative and make sure that their suppliers have the freedom to do so by not overprescribing the requirements.

Some have even created a virtual platform to allow suppliers to share breakthrough ideas with one another and feed off of each other to drive innovation. Companies that successfully practice SRM also invest time in developing an in-depth understanding of their suppliers' capabilities that enables them to execute supplier management in an operating model where they focus on the most critical outsourced products or on those suppliers that need the most help, while allowing more capable suppliers to take the lead in managing the relationship. They can then shape their contract manufacturing management organization to be aligned with that operating model and make better use of those resources.

Closing the Gap

From the survey, it became obvious that closing the gap between strategic intent and the day-to-day reality requires that companies looking to outsource manufacturing operations should, first and foremost, have an objective and a consistent make vs. buy decision process—linked to their business and supply chain strategy—that should periodically be revisited. They also need a robust supplier selection and contracting process, followed by an effective integration process and an ongoing management routine that leverages the best practices from SRM. This will lead these companies to put in place the appropriate organizational structure, with clear roles and responsibilities that can ultimately be held responsible, with confidence, to meet and even exceed the expectations and objectives that the organization has placed upon their contract manufacturers. ☺☺☺