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Out-Sourcing in Manufacturing Sector: A Global Trend

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Abstract:

Manufacturing sector is developing fast in compare to other sectors. It requires different inputs to transform the inputs into output at minimum cost with high quality products and higher speed of production. After globalization and liberalization of mostly economies, it has been observed that the key to success depends on cost, quality and speed. It is observed that india is a favourable destination for manufacturing products. The global contract manufacturing business is estimated to be close to \$ 150 billion and is expected to grow to more than \$ 500 billion by the end of the decade. It is indeed a huge market for indian players to address. Currently, the top five companies in the global contract manufacturing market—slattern, flextronics, sci, celestite and jabil account for more than a third of the global market. Other players also try to increase their market share with adopting the new technology and outsourcing different inputs. There is very tough competition to capture the global market. This case study tries to study the global trend of outsourcing to make manufacturing feasible.

1. Introduction

Manufacturing requires different inputs to transform the inputs into output at minimum cost with high quality products and higher speed of production. After globalization and liberalization of mostly economies, it has been observed that the key to success depends on cost, quality and speed. The consolidation among companies that has taken place over the past few years continues to change not only the number of industry players but also the roles they will play in the future. Companies are looking at their core competencies—like innovation, manufacturing, research and the ability to market products and evaluating where there may be opportunities to improve on agility or speed of product development and changing the layout of product. It also leads to replace the demand of other products. In order to fulfill these objectives, contract manufacturing becomes an increasingly important business strategy to sustain and develop in global competitive environment as it reduces cost of production and improve the quality of product. Theoretically, it is work sub-contracted to a manufacturer by a company that owns the product design. In some cases, the manufacturer takes the responsibility of market in the products using the vendor's brand and provides after-sales support. Credit facilities are also one step development in this process. In other words, it is the practice of making products or subcontinents of products to be sold under a different company's name. Contract manufacturing, also known as electronic manufacturing services, is attracting a host of MNCs to set up base in India. It is observed that India is a favourable destination for manufacturing products. The global contract manufacturing business is estimated to be close to \$ 150 billion and is expected to grow to more than \$ 500 billion by the end of the decade. It is indeed a huge market for Indian players to address. Currently, the top five companies in the global contract manufacturing market—slattern, flextronics, sci, celestite and jabil account for more than a third of the global market. Other players also try to increase their market share with adopting the new technology and outsourcing different inputs. There is very tough competition to capture the global market.

2. Industry Scenario

Manufacturing sector is one of the fast growing sectors in present global economy with high business potential. This sector has high job opportunities, income generation and plays crucial role for the development of global economy. In the industries today, Original Equipment Manufacturers (OEMs) are selling their production facilities to contract manufacturers (CMs). Product assembling has become a medium of establishing the new venture having low cost and minimum manufacturing risks. Increasingly, firms that traditionally manufactured their own products are out-sourcing production while focusing on produce design, development, and marketing. This trend is well defined in industry segments like electronics, Telecom, medical and pharmaceuticals where

1. Manufacturing processes are easily standardized
2. R & D and marketing costs are very high
3. Speed of innovation and time-to-market are critical
4. Product design and development are crucial to grow

The use of contract manufacturing is important and growing in a range of industries, including electronics, Pharmaceuticals, automotive, footloose, telecommunication products, fashion items and food and beverage production. These days, lots of pharmaceutical and biopharmaceutical companies are out-sourcing a significant portion of their manufacturing cost. The contract pharmaceutical out-sourcing market was estimated at \$9 billion and is expected to grow to more than \$12 billion during the next few years. Generally, smaller companies are out-sourcing more of their manufacturing costs than are large pharmaceutical companies, following a virtual company model and relying on contract manufacturers for substantial amount of their capabilities.

The trend to out-source assemble and other manufacturing activities is evident among automotive manufacturers also where companies are developing their tier-one suppliers to deliver and sequence completed subsystem modules such as carpets, seats, exhaust systems, rear axles, bumpers, and dashboard and instrument panels. It has also been an option for makers of computer equipment and peripherals for long. Given the convergence of computer and communications technologies, these services are becoming an efficient alternative for telecommunications firms as well.

3. Advantages of Out-Sourcing

As the technology is changing in a fast pace, the demands of the market are increasingly leading to a new relationship between Original Equipment Manufacturers (OEMs) and so-called electronic manufacturing services (EMS) providers. Historically, firms have done both innovation (research and development, product design, and marketing) and production in-house. Under such vertical integration, because each firm fills its demand from its own production capacity, inefficiency in the use of capacity can result. The CMs achieve high capacity utilization through pooling i.e. supplying many different OEMs. Meanwhile, the OEMs focus on innovation, research and development, product design, and marketing. Out-sourcing allows OEMs to spend more resources attending to product development, marketing and brand management. The current trend is for OEMs to focus on core competencies, such as research and development, while out-sourcing productions contract manufacturers who can perform the service better, cheaper and faster.

Out-sourcing leads to lower operational costs and reduces future investment needed to meet demands for expansion. The industry's increased reliance on contract manufacturing is not merely a short-term strategy to cope with the unprecedented demand currently facing the high-tech Industry. It makes financial sense in the long term, as well. Manufacturing is capital intensive; shifting manufacturing investment to another firm reduces debt. Apart from this, efficiency gains accrue because of specialization; economies of scale and better-man-featuring facilities located throughout the world and a global manufacturing infrastructure, electronic manufacturing service providers make it possible to achieve almost instantaneous time-to-market.

4. Hurdles on the Way

Though contract manufacturing is becoming an integral part of the high-tech business model, there are many fears that need to be addressed. The very rational fears that intellectual property will be eroded, lost, or exposed to competitors is a major outsourcing inhibitor in manufacturing. Simple difficulty in defining core competencies can also slow the outsourcing process. Control may be the most controversial aspect of manufacturing outsourcing. People with experience say it's important for the manufacturer to maintain tight control over performance parameters, troubleshooting, etc., especially during the transition to outsourcing. However, for smaller companies with less leverage, it may be much easier said than done. Although contract manufacturing improves capacity utilization, it may reduce the profitability of the industry as a whole by weakening the incentives for innovation. There is also disagreement over the extent to which manufacturers should dictate the 'how' as well as the 'what' in contract manufacturing programmes.

In spite of all these hitches, growth in the electronic manufacturing service sector is giving rest to greater confidence for investors as well as OEMs that the trend towards outsourcing will continue. Successful companies of the current economic conditions, but continue to invest its scarce resources in gaining competitive advantages, building market, and, ultimately, providing value to its customers.

5. Future Predictions

- The use of multiple service providers will continue to grow.
- Within manufacturing, the use of service providers will increase faster in the areas of festered short-team projects than in the area of long-team projects.
- Cost-effective measures utilizing advanced technology (e.g., on-demand service for on-line capacity) will become increasingly popular.

6. It's Time to Contract Manufacturing

- When a company lacks the resources to handle a project
- When the function is not a core competency
- When a product must be developed quickly
- When the need is short-term
- When a company wants to explore completely new business
- When a company wants to minimize cost of production

7. Attempt the Following Problems

1. MNCs and large size companies want to concentrate on innovation, design, developments, market share and off load routine work of processing to outsiders. Explain this with justification from quality and competition point of view.
2. Does out-sourcing mean passing the financial burden on small units? Explain from Indian context.
3. Do you believe Indian automobiles can over depend on SSI and medium industries and maintain quality and quantity standards? Discuss.
4. Cost, quality and speed is the key to success in corporate world. What is the relevance of this statement in the manufacturing sector in changing global trend?

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