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Off-Shoring Friend or Foe?

Last month I briefly discussed the matters around the definitions and meanings of “manufacture and production”. Manufacturers can and do outsource or even establish offshore production and keep control of the channel to customers firmly in local hands. This is a kind of devolution that is preferable to “cheap imports” off-shoring manufacturing, where the New Zealand consumer is simply an end point in someone else’s channel that has no local control.

Off-shoring production is far preferable to the option of off-shoring manufacturing. However, off-shoring production is not the cure-all that it is often held out to be – it suits some situations but it does not make sense in every case.

Supply chains are often complex and contain a huge amount of tacit knowledge and understanding that is not captured in contracts, specifications drawings and the like. Such tacit knowledge often reduces the inherent cost in supply chains in ways that are not explicit. The supplier knows what to do to satisfy the buyer even though the buyer has not clearly specified the requirements.

There are other implicit threats in major changes to a bedded down and functioning supply chain. What happens to inventory levels? How will obsolescence be dealt with? How will quality be maintained? Will intellectual property be threatened? How will new currency risks be managed? How will engineering change be managed? What are the vulnerabilities to freight cost changes? And perhaps the key question, how will the customer interface change and be managed?

Issues around competitive advantage need some careful thought, where might the real competitive advantage be? For example, in a situation that is built around rapid customer response; customer choice, tailored solutions, low volume, rapid technology change, safety and low direct labour content would not be an obvious choice for off-shoring. The production requirements of manufacturing business, unlike service industries, carry the fishhooks mentioned. Large firms moving production off-shore might place local supply chains in terminal decline, capability is lost to all and the ability to develop products based on supply chains is also lost. Protecting the supply capability to underpin the development of future products should also be built into the off-shoring decision.

In considering the cost end of competitive advantage it is worth knowing the input cost breakdown. One definition of elaborately transformed manufacture is a direct product cost at something less than half the selling price. Profit and overhead cost make up the rest and is also the source of the value end of competitive advantage.

Building the cost end competitive advantage requires a focus on labour productivity and raw material costs. In many firms the cost of material is around ten times the cost of direct labour and chasing the lowest labour rate may not be the smartest thing to do. Much bigger savings can often be obtained from upgraded purchasing and logistics.

Ever increasing labour productivity is a necessary competitive response that will also reduce the attractiveness of off-shoring to low labour cost countries, particularly for manufacturers that have the niche characteristics discussed here.

Smart off-shoring works, off-shoring as a knee jerk can be as destructive to local industry as the "cheap imports" route to off-shoring.

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