

**wbs**

WARWICK BUSINESS SCHOOL  
THE UNIVERSITY OF WARWICK

**For the  
Open  
Minded**

# Supply Chain Operations

## Part 2

Outsourcing

# What is outsourcing?

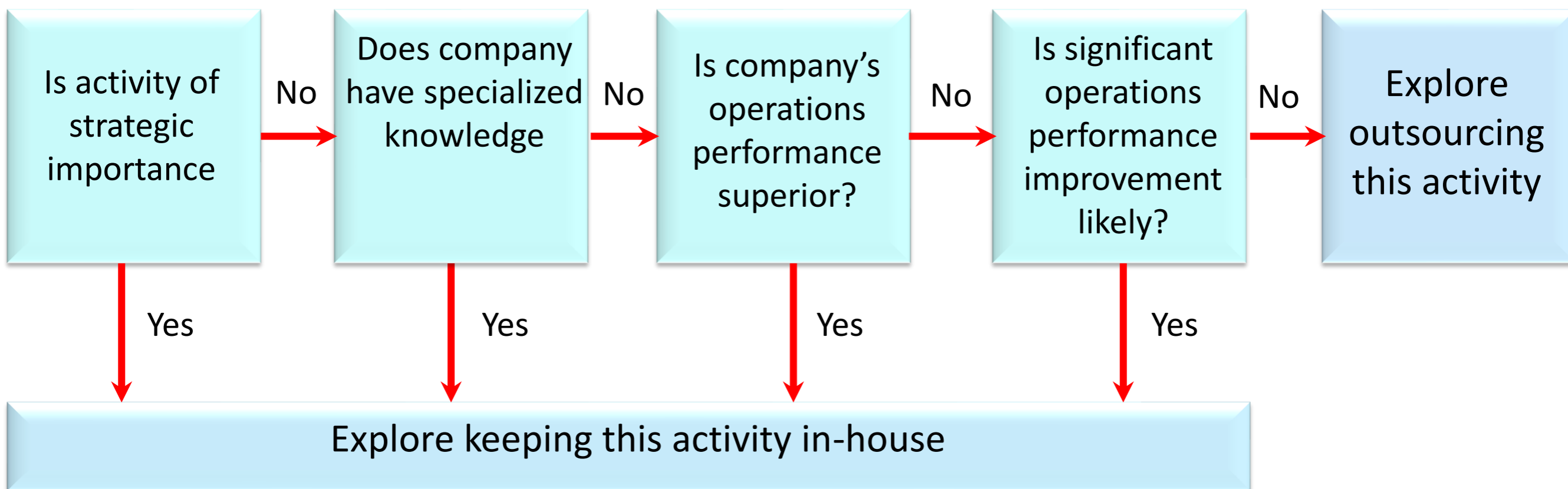
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... the process of transferring an existing business activity, including the relevant assets, to a third party



# Outsourcing: Make or buy decision

## The decision logic of outsourcing



Nigel Slack, 2009

# Determinants of the outsourcing decision

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## Dependency on capacity

- Firm has knowledge and skills, but not capacity

## Dependency on knowledge

- Firm does not have knowledge and skills (how do you select suppliers if you don't have knowledge)

## Toyota

- Engines - knowledge and capacity, 100% in-house
- Transmissions - knowledge, designed in-house made by suppliers
- Electronics systems - designed and made by suppliers

Simchi-Levi, D., Kaminsky, P. & Simchi-Levi, E. (2008)  
Designing and Managing the Supply Chain: Concepts,  
Strategies and Case Studies. 3rd edition. New York,  
McGraw-Hill Irwin.

# Outsourcing and Offshoring?

# Outsourcing and Offshoring?



# Benefits and Risks of Outsourcing

Discuss:

1. Benefits and risks to the organisation
2. Benefits and risks to the industry/nation/governments/local economy

# Outsourcing – organisational effects

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## Benefits/opportunities

- Enable focus on core
- Reduce costs, providing short-term balance sheet and P&L benefits
- Increased flexibility to configure resources
- Increased ability to meet changing market needs
- Provision of benefit through economies of scale and scope
- Ability to access best in class skills and capabilities
- Freeing of constraints of in-house cultures and attitudes
- Provision of fresh ideas and objective creativity

e.g. Boeing 787 outsourced design and manufacturing of crucial components 30% more than industry average. E.g. stopped providing blueprints for component suppliers. Resulted in 3 years delay & billions lost.

## Risks/disadvantages

- Failure to identify core and non core may lead to outsourcing core
- Difficulty in insourcing later
- Difficulty in deciding how close to core outsourcing should get
- Lack of skills and competence to manage outsource relationships
- Increased costs in relationship management
- Lack of understanding, skills and competence to design appropriate service level agreements with outsource company

Harland, C. et al., 2005. Outsourcing: assessing the risks and benefits for organisations, sectors and nations. *International Journal of Operations & Production Management*, 25(9), p.831-850.



# Outsourcing – sector effects

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## Benefits/opportunities

- Provides opportunities for niche players to enter a sector, enabling original sector players to focus on core
- Improvement of products and services from the sector
- Improved ROI, leading to increased investment in the sector
- In public sector, policy can be redirected to focus on improvement of services

## Risks/disadvantages

- Privatisation by stealth
- Reduction of government control over sector
- Creation of powerful outsource companies who gain leverage over a sector
- Possible adverse impact on employment in the sector
- Possible reduced consistency of training and development
- May conflict with some stakeholders' objectives

Harland, C. et al., 2005. Outsourcing: assessing the risks and benefits for organisations, sectors and nations. *International Journal of Operations & Production Management*, 25(9), p.831-850.

# Outsourcing – national effects

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## Benefits/opportunities

- Increased use of world-wide “best in class” capabilities
- Enables national focus on improved services to citizens and taxpayers
- Improved GNP and employment for nations who become outsource centres of excellence

e.g. NHS – IT systems outsourcing 2002 circa £9.8bn of overall losses

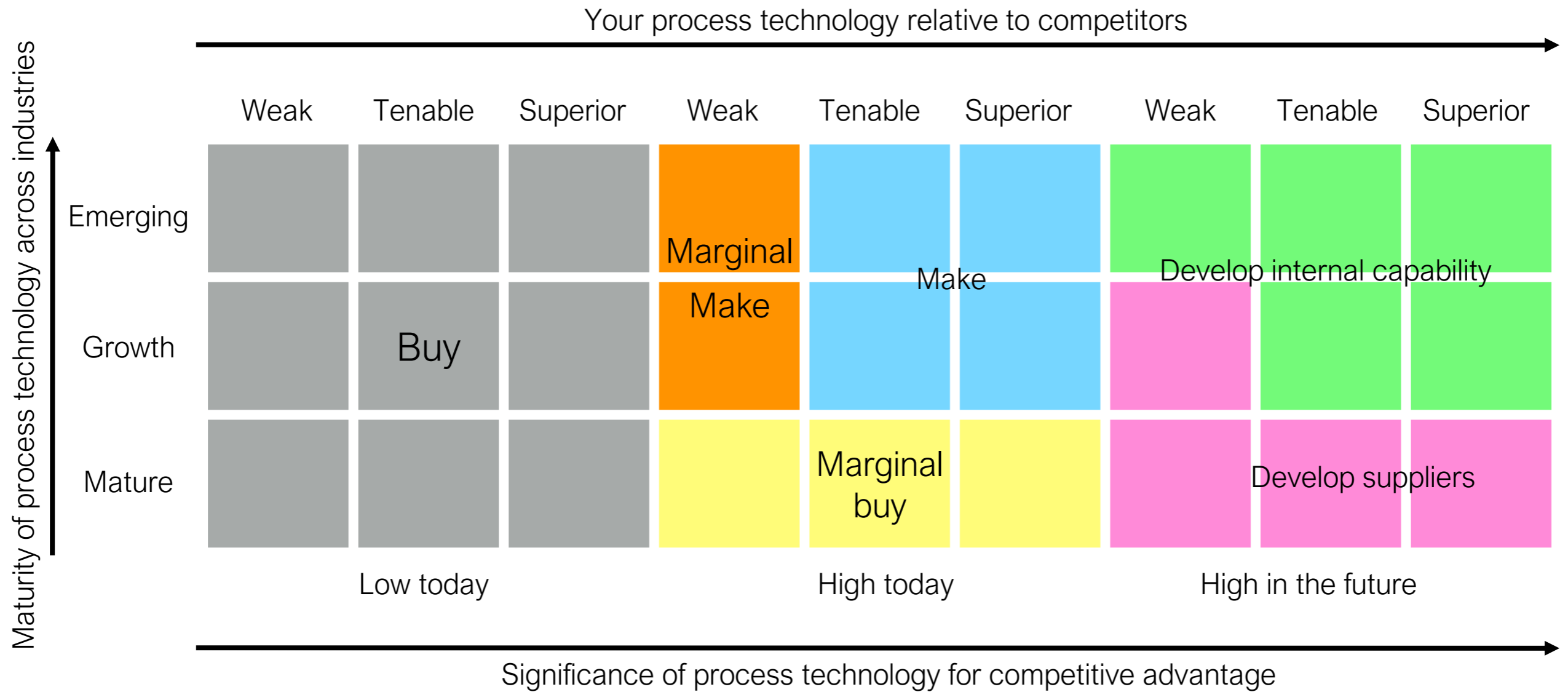
“This saga is one of the worst and most expensive contracting fiascos in the history of the public sector”. Member of Parliament

## Risks/disadvantages

- Possible adverse affect on national employment
- Downward pressure on domestic salaries
- Mismatch of international cultures, beliefs and traditions
- Risk of foreign control of critical resources and possible subversion
- International exploitation of less developed nations human resources and environment

Harland, C. et al., 2005. Outsourcing: assessing the risks and benefits for organisations, sectors and nations. *International Journal of Operations & Production Management*, 25(9), p.831-850.

# Outsourcing frameworks



Welch and Nayak (1992)

# Examples of service outsourcing:



Signed a 7-year, £1.7 billion contract with Accenture to cover design, building implementing and running all the retailers' IT systems and networks. Terminated in 2 years.



Dell moved product support for business accounts from India back to the U.S. in 2003, after two years of operation.



Signed a 7-year, \$5 billion contract with IBM to cover data centers, help desks, distributed computing, data and voice networks. Terminated after 21 months of operation.



HP – Taiwanese Supplier issues faced with outsourced services such as marketing and manuals. "This glamour of new product will perfectly fit to your daily life from any of locations!"



A major outsourcing fiasco happened during Olympics, where Armed Forces had to step in as the security services provider G4S shortly before the event announced it did not have enough resources



Signed a 5-year, \$195 million contract with Computer Science Corporations for help-desk services, desktop systems, and network operations. Terminated in 1.5 year.

# A recent survey on outsourcing

- ⦿ What are the key drivers for successful outsourcing partnerships?

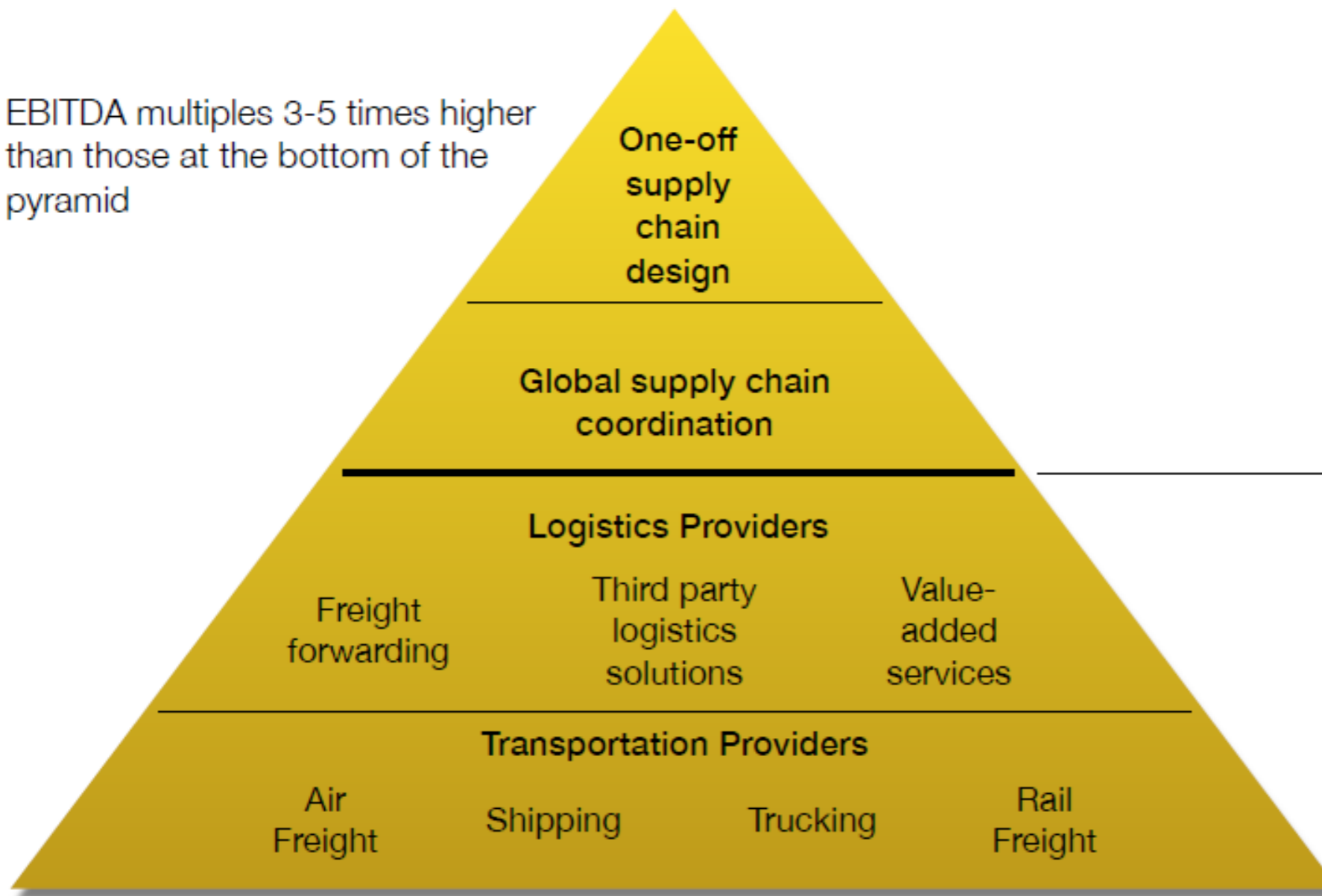
# A recent survey on outsourcing

- ◎ What are the key drivers for successful outsourcing partnerships?
  1. Service reliability
  2. Cost
  3. Understanding customers business
  4. Trust
  
- ◎ The 'softer' and less quantifiable elements of an outsourced relationship are more often the ones that make the most difference

<https://www.cips.org/supply-management/news/2015/june/cost-second-to-reliability-when-it-comes-to-outsourcing/>

# Outsourcing Logistics Services: What is the difference between 3PL and 4PL?

EBITDA multiples 3-5 times higher than those at the bottom of the pyramid



A 4PL provider is a supply chain integrator that assembles and manages the resources, capabilities and technology of its own organisation with those of complementary service providers to deliver a comprehensive supply chain solution.

A 3PL is a provider of third-party logistics execution and improvement of specific supply chain functions (Supply chain management). Manages a logistics function (warehousing, freight forwarding, transport) using own assets for someone else.

# Purchasing vs procurement

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Usually, Purchasing refers to actual buying, while Procurement has a broader meaning

Procurement can include different types of acquisition: purchasing, rental, contracting and so on as well as associate work of:

- selecting suppliers
- negotiating
- agreeing terms
- expediting
- monitoring supplier performance
- Warehousing & receiving goods



# The main activities of procurement

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Developing purchasing strategies and policies

Identifying sources of supply

Negotiating contracts

Maintaining a database of suppliers /Optimize supplier base

Obtaining goods and services

Managing suppliers as supply chain partners – key supplier relationship management – *(Topic covered next week)*

Ensuring the day-to-day supply of products and services (i.e. the traditional purchasing role)

Working with designers to anticipate future sourcing needs

Aligning purchasing strategy with the corporate strategy

# The five 'rights' of procurement

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- ... of the right quality
- ... the right quantity
- ... delivered at the right time
- ... at the right price
- ... from the right source

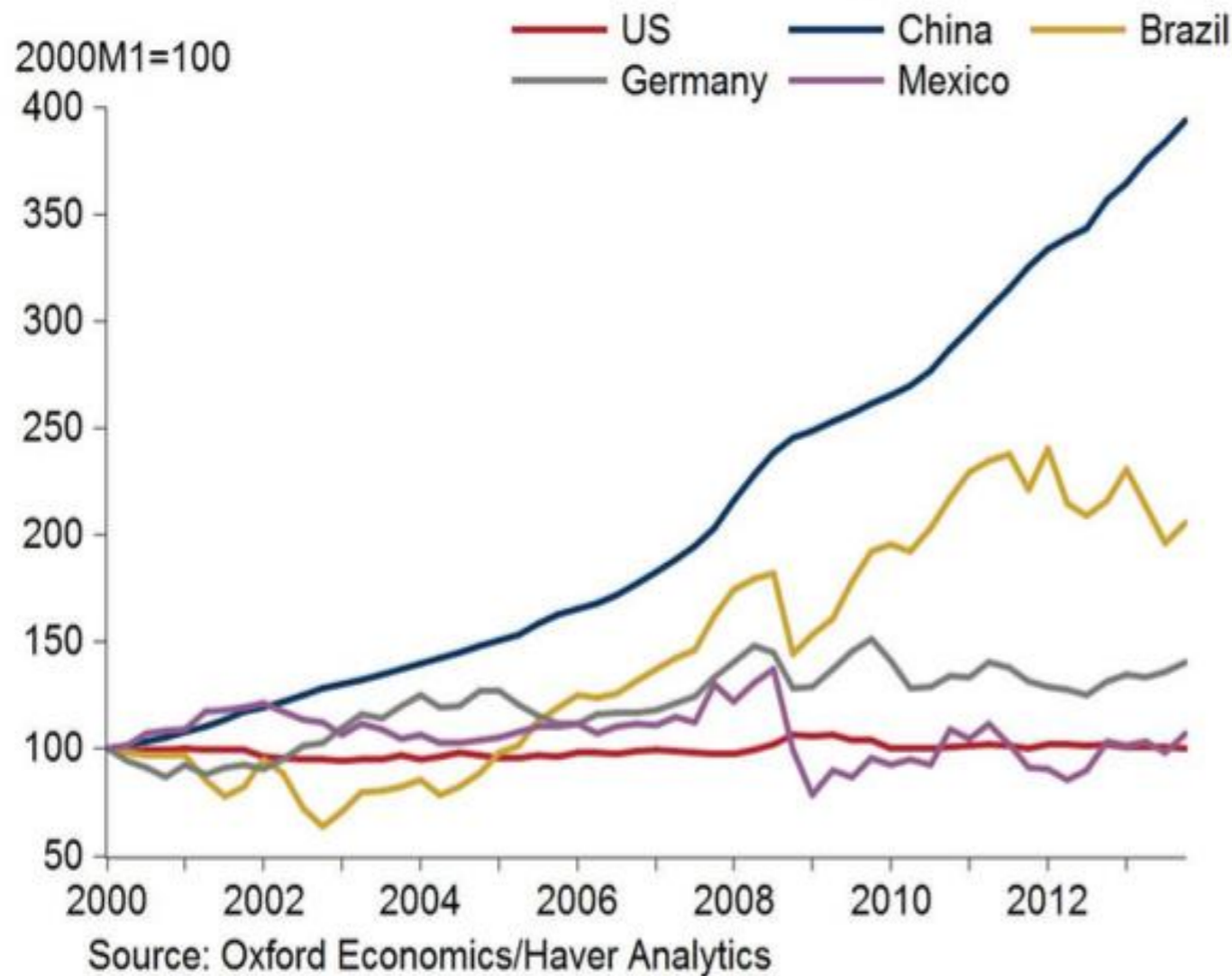
# Re-shoring – an emerging practice

- ⦿ Bringing back operations from outsourced destinations to produce near the customer markets. (localization)
- ⦿ Outsourcing is criticized and seen by some as a ‘herd mentality’ – i.e. it is not always a rational decision to outsource to China
- ⦿ Expanding to China gives boost to shareholder value and reputation but most cases are only assessed based on unit cost rather than TOTAL COST so transportation, delay, and incompatibility issues are not taken into account.

<http://www.reshorennow.org/to-reshore-or-offshore-how-to-objectively-decide.pdf>

# Some re-shoring figures

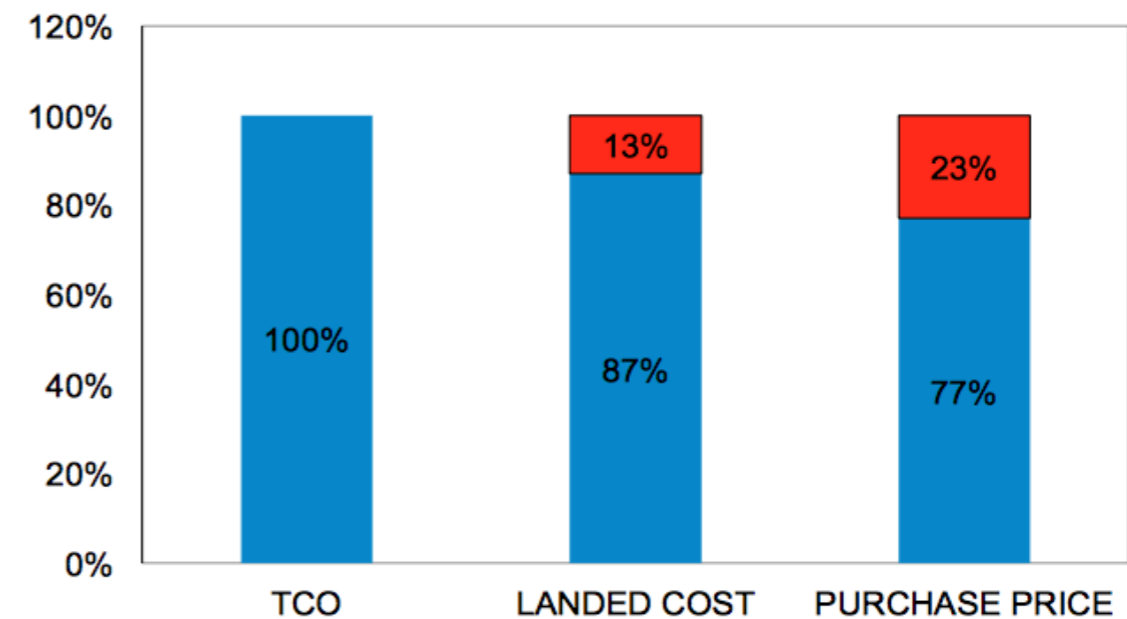
## US: Unit labor costs in manufacturing in US\$



| Comparison Basis | % of cases where U.S. has the advantage |
|------------------|---|
| Price            | 5%                                      |
| TCO              | 53%                                     |
| Difference       | 48%*                                    |

\*Conservatively 25% might return if companies shifted to TCO

Source: TCO user database



<http://www.reshorennow.org/to-reshore-or-offshore-how-to-objectively-decide.pdf>

# Re-shoring & outsourcing videos

- ◎ Why companies are re-shoring back to Britain by BBC

<http://www.bbc.co.uk/news/av/business-26235707/why-companies-are-re-shoring-back-to-britain>

# Future of Outsourcing

- ◎ Reshoring due to Covid
- ◎ Co-sourcing: collaboration between buyer & provider
- ◎ Outsourcing types :
  - Pay per use type contracts (sharing economy)
  - Outcome based contracting
- ◎ Digital outsourcing
- ◎ Outsourcing to Robots

Please read this article to be discussed in the Live lecture

<https://www.bbc.co.uk/news/business-45272835>