A SOLUTION WHITE PAPER

Value Chain Ecosystems of the Future – The Role of Outsourcing in Supply Chain Strategy
EXECUTIVE SUMMARY

Open versus closed supply chains: the difference boils down to a reliance on standard components, processes and markets as the basis for open networks, as opposed to the closed supply chain’s more highly integrated, and generally more complex, network of suppliers, designs and delivery mechanisms. At its core, this dilemma focuses on outsourcing strategies and how supply chain executives weigh the tradeoffs between cost, time, value, risk and other business imperatives associated with designing the value chain ecosystem of the future.

What this study of 839 senior-level supply chain executives uncovers, first and foremost, is that supply chain is a strategic enabler of growth for the business. Against this backdrop, it comes as no surprise that customer demand overwhelmingly sits at the top of the list of business pressures that our respondents face.

As the report digs deeper into the key areas that industry outsources, unsurprisingly, transportation has the highest response rate. More interesting, however, are the areas of product postponement and configuration & fulfillment. It is clear from this study that industry considers these both these fields as potentially better handled by specialists and indeed therefore represent good opportunities for third party support.

And when it comes to differentiating between open and closed supply chains, the most significant difference applies to the area of factory supply, with open supply chains favouring third party support in this field much more than their closed counterparts. This can be explained by the deeper, collaborative relationships OEMs generally have with their component suppliers in a closed network.

In alignment with modern-day focus for supply chain on driving growth through customer service, the greatest concern amongst respondents lies with customer service quality, with nearly two-thirds citing this as an issue of importance.

Transportation once again leads the way when it comes to outsourcing market readiness, undoubtedly as a result of long-established industry need to move freight around the world. At the other end of the spectrum sits product design, manufacturing and assembly. This might be down to an apparent lack of technical competence and/or reliability of execution. Both of these are clearly identified as the major traits necessary in a perceived market-leading outsourcing provider.

Further, as one might expect, industry continues to place a strong emphasis on competitive pricing and market knowledge.
Key highlights of the study include:

- Customer service experience quality concerns prove to be the most significant barrier for 68% of respondents
- Product postponement, with 57% of respondents asserting it significantly prepared to meet industry needs, remains an area with high expectations for outsourcing
- Technical competence and reliability are the key strengths of outsourcing market leaders, with 72% and 70% response rates respectively

INTRODUCTION

As supply chain strategists around the world face the daily challenges of cost containment, perfect order fulfillment and ever accelerating product innovation, many are beginning to wonder how some, notably Apple, are able to accomplish so much with a supply chain strategy that is more closed than open. The difference boils down to reliance on standard components, processes and markets as the basis for “open” supply chains versus the more highly integrated, and generally complex network of suppliers, designs and delivery mechanisms characteristic of “closed” supply chains. At its core, this dilemma is all about outsourcing strategies and how supply chain executives weigh the tradeoffs between cost, time, value, risk and other business imperatives associated with designing their value chain ecosystems for the future.

On one hand, the appeal of an “open” supply chain strategy includes access to lower cost components, often with less risk since suppliers can spread their development bets across multiple customers. Open supply chains are also less likely to be disrupted by failures further up the chain, as alternative suppliers should be easier to find and bring on board. Closed supply chains, in contrast, accept these shortcomings in return for closer collaborative ties between companies working together to bring a product to market. The benefits arising from closed supply chain strategies include deeper sharing of intellectual property like designs, technologies and launch plans which may allow for superior product performance and margin protection as proprietary capabilities separate first movers from fast followers. One of our respondents summarised the dichotomy well:

“[Our Company] is a hybrid of both strategies depending on the end product and application/market but overall is a highly complex network of internal and external multi-stage manufacturing and logistics across the globe. Advantages of the ‘sole sourced’ is generally higher returns along with higher risk, and advantages of ‘standard’ strategy is a more steady stream of business but generally lower returns.”

In both open and closed supply chains, outsourced support for everything from product design to transportation is available and apparently growing both in volume and sophistication. What are the advantages offered to strategists seeking outsourced support across the range of activities they must manage and what are their concerns? Are there differences in the way outsourcing should be approached based on the preference for open vs. closed supply chain strategies? Recent field data shows substantial differences in the maturity of outsourced supply chain support markets, as well as their suitability to closed vs. open supply strategies.

VALUE CHAIN ECOSYSTEMS OF THE FUTURE

Supply Chain Strategy – Open vs. Closed Perspectives

Years have passed since supply chain was universally regarded as a simple cost centre for the business. Today’s supply chain strategy is generally driven as much by top line concerns as cost control and, as shown in figure 1, the most common primary purpose of supply chain strategy over the next couple of years is decidedly a focus on enabling revenue growth. Second in importance for near term supply chain strategies is a focus on taking costs out of operations. Relative to these two master imperatives, other concerns are clearly second tier – among these are improving new product launches, improving cash flow and reducing risk.

![Figure 1: How would you characterise the primary purpose(s) of your supply chain strategy for the near (12-24 months) future?](source: Euromonitor International, 2013)

When responses to this question were cut according to those who classify their strategies as “open” vs. “closed”, some distinctions emerge. Those preferring an open strategy are significantly more likely to consider as “most critical” the focus on reducing risk and improving cash flow than those preferring
a closed strategy. In contrast, closed supply chains place a higher emphasis on improving product launch than their open counterparts. This is evident both at the high end where closed supply chains more frequently call improved product launch “most critical” and at the low end where open supply chains are almost three times more likely to call product launch “not important” than closed supply chains.

It is important to note that many respondents who offered qualitative input to the study said their approach to strategy is more a combination of closed and open supply chains depending on product maturity or other market conditions. Still, it is clear that open supply chains serve the business by limiting business exposure to market uncertainties while closed supply chains are biased toward a higher-risk, higher-return model.

**Supply Chain as Equal Partner?**

When asked to characterise their current supply chain organisations, respondents overwhelmingly agreed they were “a strategic enabler for the business” (55%) rather than a “cost centre for the business” (20%). This is no surprise and the data, when cut according to closed vs. open supply chains, shows remarkably little difference. As might be expected, open supply chains are marginally less likely (55%) to see themselves as a strategic enabler than closed supply partner to sales/marketing/engineering”. The implication is that open vs. closed strategies may indeed imply a different risk/return profile in terms of outsourcing and supplier management, but that each has a comparably powerful seat at the table with business leadership.

In fact, some of our respondents’ comments described the relationship of supply chain to the business as a whole in terms that clearly show this attitude:

“Supply chain strategy is NOT a standalone strategy and ultimately needs to support the business requirements of the company. By using an open model, the supply chain strategy can be built in a modular way and is able to respond faster and better to any new requirements of the business.”

And whether the nature of the business calls for an open or closed approach, many executives are able to articulate why they approach supply chain in definitive business terms:

“Based on the complexity of products, we are more [of a closed supply chain] as we need to develop a complex supplier network and some components are not ‘marketable’ but more customised; we are a hi tech company generally offering top end products to the market.”

In neither case is the supply chain organisation operating blindly as a cost centre, but instead is interwoven into the businesses competitive strategy. Outsourcing in this context is certainly about more than merely finding a third party who can do the job more cheaply. Even among open supply chains, the key benefits, as we will see later, are as much about flexibility, technical competence and speed.

**Business Pressures on Supply Chain Strategy**

In terms of pressures impacting supply chain strategies, customer (not consumer) demands are predictably at the top of the agenda with more than a third of all respondents (34%) calling it “most critical”. A close second was the pressure of “ongoing economic volatility and uncertainty”. This outcome is reflective of a newly intensified sense of unease permeating most of the global business environment. Supply chain, by virtue of its role as the mechanism for balancing supply and demand, feels this pressure acutely and thus ranks it above competition, consumers, technology and investors as a source of anxiety.

![Figure 2: Which of the following best describes your current supply chain organisation? A comparison of “open” vs. “closed”](image)
The differences between open and closed supply chains with respect to important business pressures illustrate the nature of the strategic choice. While both feel the heat of customer demands similarly, open supply chains are significantly more sensitive to consumer preferences – 27% say this is most critical, against only 22% of closed supply chains. Closed supply chains however are notably more impacted by technology trends, economic volatility, investor expectations and competitive threats. This data shows the choice between closed approaches, which require tightly weaving multiple parties together, in what is hoped to be a successful and defensible market position; and open approaches, which can more easily adjust to technology or competitive shifts, but cannot as readily influence consumer demand.

What to Outsource, and What Not to
The choices supply chain strategists make regarding outsourcing start with assumptions about which supply chain activities are appropriate to yield to a third party. Traditional logic says that non-core functions can and should be considered for outsourcing, especially if third party specialists have superior skills or market power to offer any combination of lower costs and better results. As is perfectly clear in figure 4, transportation stands alone as an activity that fits this bill. Sixty two per cent of our 859 respondents said that transportation was “always appropriate” for outsourced support. Owing to the modern global transport system of containerised shipping and a worldwide network of plants providing parts and/or finished goods, most supply chain professionals long ago ceded the idea that their own fleets of truck, rail or air equipment, let alone ocean-going vessels, is something to be handled in-house.

THE SPOTLIGHT ON MÖLNYLCKE HEALTHCARE
Anders Klinton, EVP, Supply Chain Management, Mölnlycke Healthcare

At Mölnlycke Healthcare, the cornerstone of its approach to outsourcing is delivering value. “It really forms a core part of our business as we believe it gives us a competitive advantage and protects us from our competitors”, asserts Anders.

Part of Mölnlycke Healthcare’s manufacturing operations is outsourced, while a significant proportion of its IT function is outsourced as well. Additionally, Mölnlycke prefers to take the external route with management of its warehousing and distribution. “This could be an internal operation but resources dictate that we work with an external partner”, comments Anders.

To ensure its numerous outsourced operations work effectively, Mölnlycke places significant emphasis on the relationship dynamic. “It’s not merely about the numbers and costs”, Anders claims, highlighting the importance of the cultural point of view. “Does the partner understand our requirements and do we, in turn, understand the context under which the partner operates?”. It goes beyond simply measurable factors and cost. “It’s far more concerned with the cultural aspects: people, competencies and how aligned our businesses are”.

What tends to hinder this, from Mölnlycke Healthcare’s standpoint, is the internal state of play. “The number of projects we have at any one time can impact our outsourced engagements. We might be focused on expansion or, rather, cost reduction, but nevertheless our activities in general can frustrate our success”. Additionally, reacting to change is a challenge which Mölnlycke believes can prove a barrier to successful outsourcing. “Sometimes we can be slow to react to the market. We inevitably encounter numerous urgent situations and we are sometimes too slow to respond”. Anders cites the example of Asia. “We all know costs are increasing. Should we look for alternative opportunities now? Can we wait until next year?”. The speed with which a business reacts can make all the difference.
At the other end of the spectrum, supply chain strategists are less convinced about the role outsourcing should play for product design, manufacture and assembly. This activity scored lowest for a number of respondents saying it was “always appropriate” to outsource (13%) and highest for “never appropriate” (23%). One shortcoming of the research that we will look to remedy in future, however, is the lack of distinction between design, manufacture and assembly as separate steps. It is possible that figures for design might be very different, for example, from those for assembly.

The more interesting data surrounds those supply chain activities between these extremes, notably two areas that scored relatively highly and are clear opportunities for outsourcing. Product postponement, meaning final packaging or kitting services and configuration & fulfilment, meaning order completion and shipment, both saw a majority of respondents call these areas either 4 or 5 on our five point scale (5 meaning always appropriate to outsource and 1 meaning never appropriate). This suggests that most supply chain strategists consider postponement and configuration & fulfilment to be good candidates for third party vendor support. Considering the proven ability of some logistics providers and other supply chain outsourcers to handle these ancillary production tasks, such areas may for many be both non-core and better handled by specialists.

Another area that appears ready for outsourcing is factory supply (sourcing of standard parts). Like configuration & fulfilment, factory supply shows a clear majority who believe it is always appropriate for outsourcing (23%) and a reasonably small share (8%) that think it is never appropriate. Unlike configuration or postponement, however, the factory supply function could be seen as core in that it drives profitability by directly and often heavily affecting cost of goods sold. Its appropriateness for outsourcing more likely arises from the potential of large scale sourcing specialists to secure advantageous pricing with bulk buying power – something impossible to do in-house for most companies.

Less clear are three areas that the data presents as potential opportunities. E-commerce (electronic order capture, fulfilment and payment receipt) is considered “always appropriate” for outsourcing by a mere 16% of respondents – barely more than the 12% who say it is “never appropriate”. This may be in part because the skill and/or technology demands of e-commerce are relatively high (as we will see below) and in part because customer demand, as we saw above, is the most important pressure point felt by supply chain strategists. In either case, it is clear that e-commerce is at best an activity that may, in some cases, be suitable for outsourcing. Similarly unlikely are returns & repairs and spare parts management. Both of these activities are considered appropriate for outsourcing by a small majority overall, but nearly one in ten respondents in each case said they were “never appropriate”.

When we split this data set according to whether respondents identified themselves as open vs. closed supply chains, we can see some of the underlying behaviours that separate activities well suited to outsourcing from those that are not. The biggest difference between open and closed supply chains here is around the topic of factory supply. Open supply chains decisively favour outsourcing in this area (29% say it is always appropriate) with little reservation (only 6% say it is never appropriate). In contrast only 18% of closed supply chains say factory supply is always appropriate for outsourcing, while 11% say it is never appropriate. These figures reflect the deeper collaborative relationships OEM’s generally have with their component suppliers when they pursue a closed strategy. Exchange of technical information and the value of iterative learning cycles between supplier and OEM moves this activity a lot closer to the core of the business and at the same time, limits the open strategy benefits of allowing suppliers to spread development costs across many customers. Outsourcing strategists must certainly take these factors into account then when choosing what to hand over to a third party.
Another predictable difference between open supply chains and closed supply chains is around the product design, manufacture and assembly activity. Open supply chains see this as always appropriate 14% of the time against closed supply chains that agree with the 5 ranking only 11% of the time. If responses supporting outsourcing are taken to include not only 5’s on our five-point scale but 4’s also, the gap between open and closed supply chains is even wider: closed supply chains favour outsourcing design, manufacture and assembly 28% of the time while open supply chains favour it 36% of the time. The bias among closed supply chains clearly is to keep design, manufacturing and assembly in house.

Open supply chains are also more enthusiastic about both e-commerce and returns & repairs than closed supply chains, suggesting less interdependency between links along the value chain for those leaning toward standard, interchangeable parts and functions. Again, these results, while not strongly pointing to different attitudes about outsourcing, do at least directionally support the idea that closed supply chains are less comfortable relinquishing value chain functions to outsiders.

Of equal interest in the split between open and closed supply chains is the set of areas where their opinions as shown in the data are virtually identical. This is true for transportation, postponement and configuration & fulfilment. Considering how closed supply chains clearly prefer to keep factory supply and product design, manufacture and assembly close to home, it is interesting that they are as comfortable outsourcing these other areas as are open supply chains. The case of transportation may explain this data since regardless of openness, supply chain strategists universally see this function as both easy to outsource and unlikely to threaten or undermine the value proposition they aim to deliver. Similarly, postponement and configuration & fulfilment stand as examples of supply chain functions that, although less mature than transportation, nonetheless are unlikely to play a key role in supporting a closed supply chain strategy.

Concerns with Outsourcing

Another way of looking at the role outsourcing should play in a value chain ecosystem is to drill into what concerns supply chain strategists have about third party support in general. The number one and two top concerns overall were, perhaps understandably, in the areas of quality. First, with 30% of respondents calling it a “major concern” is the question of customer service quality problems. Combining those who ranked this concern a 5 with those who ranked it a 4, we have over two thirds of all respondents citing this as an issue of importance. Product quality concerns, although less prominent than customer service quality worries, still managed to register nearly 61% of respondents who ranked this as a 4 or 5 on our five point scale.
The next biggest concern overall was loss of control over intellectual property, followed reasonably closely by loss of customer intimacy. Over half of respondents saw loss of IP control as a significant worry while 46% are concerned about customer intimacy. Although this data does not include any time series information, it seems fair to surmise that the high level of concern over IP protection reflects a growing problem here, as more and more technology, fashion, and pharmaceutical companies cite IP theft and counterfeiting as a serious challenge. An interesting quirk in the data, however, shows that both IP control and customer intimacy score relatively high levels of respondents willing to say that these issues are “not a concern”. More than one in ten respondents to both of these questions saw no reason to worry at all, perhaps indicating a significant subset of supply chains who have failed to see the potential impact of these matters on their business.

In two areas where reliability was investigated, of cost and volume commitments, the data shows comparatively little concern. The share of respondents calling these a “major concern” (5 on our scale) was nearly tied with the share ranking the issue a 2. Interestingly, the percentage ranking these a 1 (“not a concern”) was very low (3% and 4% respectively), perhaps suggesting that while reliability is not a major concern, it remains always at the “back of the mind”. Outsourcing seems to have earned the confidence of supply chain strategists in general, although no one is prepared to let down their guard completely on this most vital of issues.

Less important as a concern is the loss of visibility on costs. The role of outsourcing in supply chains could be seen as a black box in which the buyer of third party services loses insight into cost structures and thus is at risk when underlying economics for labour or commodities start to shift. Only 14% of respondents saw this as a major concern, suggesting that either their ability to see costs through the third party is reasonable or that third party cost control is well enough maintained that buyers feel free to ignore it and accept the black box outcomes i.e. how they do it is their business.

Finally, we asked whether outsourcing in supply chain is a concern for any companies simply because it clashes with their culture. This rated lowest overall and thus cannot be considered an important concern. However, the data shows a very large gap between the share who do in fact cite this as a level 5 concern (12%) and those who rank it as a level 4 (28%). One interpretation of this data says that a small group (11%) sees a real barrier to outsourcing based policy or ownership structure while many (28%) worry about a softer barrier, like acceptance among staff or openness to outsiders. If this interpretation is correct, then roughly one in ten companies will not move to outsourcing regardless of how other concerns evolve over time.

Looking to the distinctions in concerns about outsourcing between open and closed supply chains, a couple of findings emerge. First is the clear worry closed supply chains have about loss of IP control. As figure 7 shows, not only are closed supply chains substantially more likely to cite this as a major concern (27% vs. 20% for open supply chains) they are also dramatically less likely to call it a non-concern (4% vs. 11% for open supply chains). The data certainly supports the idea that closed supply chains will approach outsourcing differently than open supply chains and that the issue of IP integrity is a critical one to address for any third party provider hoping to win such business.

The only other important difference between open and closed supply chain concerns about outsourcing is the huge gap separating closed supply chain respondents’ ranking customer service quality a level 5 concern and those ranking it a level 1 concern. The gap is in fact one of widest 1 to 5 gaps anywhere in the survey – 30 percentage points. Also interesting is the extremely low percentage ranking the concern a 1 (1.2% for closed supply chains). The implication is that customer service quality worries are a massive issue for closed supply chains.
chains whose high degree of value chain interdependency extends all the way through to the customer. This makes sense for supply chains oriented to make or break product launches with a large amount of demand creation woven into the business strategy. Open supply chains, by contrast, call customer service quality concerns as a non issue (a 1 ranking) nearly 6% of the time.

Outsourcing Markets’ Readiness
Having looked at which functions supply chain strategists are ready to outsource and what concerns these present, we wanted to get some idea of which outsourced supply chain support markets are robust enough to handle the job. Transportation stands out very clearly as “fully prepared to meet your needs”. This should be little surprise given, as discussed above, the well-established need for third parties to manage the equipment and skills required to move goods around the world. At the opposite end of the spectrum is again the product design, manufacture and assembly outsourcing market, which respondents were more likely to call “unacceptable” with a 1 ranking (15%) than “fully prepared” with a 5 ranking (14%).

THE SPOTLIGHT ON SVP
bo-Inge Stensson, SVP, group Purchasing, SKF

Over the past decade, SKF has outsourced a significant number of operations. “The outsource debate has always been top of our agenda”, bo-Inge asserts. “Our current strategic vision is to become a knowledge engineering company and sourcing/purchasing therefore becomes critical to creating a competitive supply base that can support this vision”. The question SKF always considers is what the company can best manufacture itself and what it can best outsource. “This will determine how we develop our suppliers and integrate them in a smart way to support our company strategy”.

And a key aspect of this is a culture of open and shared innovation. “In order to become a knowledge engineering company, we need to know how to integrate different technology platforms and systems. We therefore need to find a partner who can offer high knowledge in this area which in turn can deliver a competitive advantage”. For SKF, this requires working with outsourced suppliers as value integrated support partners, collaborating closely to deliver value. “This enables us to work in a smarter fashion, with an emphasis on shared product and process innovation, which in turn will create that competitive advantage”.

Nevertheless, SKF still experiences traditional challenges when it comes to the outsourcing discussion. “We are a traditional manufacturing company and will remain so to a large extent. Consequently some factories want to do everything themselves”. bo-Inge continues, “nevertheless, we try to maintain an open debate in the company so that if we cannot make something better ourselves, then we will decide to outsource”. but then this leads to another inevitable barrier, with actually identifying and locating a partner a major challenge. “It’s not easy finding the best supplier for your business. We have numerously found ourselves needing to put a lot of effort into supply development activities”.

For instance, SKF measures the performance of all its suppliers on a five-part metric: quality, cost, delivery, innovation capability and management capability. “but key to all of this is alignment, culturally and in business terms”. For SKF, a key element to making such a relationship work, beyond alignment, is long-term trust. “We’re talking about leading-edge technology and major investments so when we go ahead on such projects, we want to move quickly with our partner”. Importantly, it is never a quick fix. “We look for a long-term relationship, working with our partner for a long time, based on our performance metrics”.

Figure 8: Which outsourced/third party supply chain support markets do you consider prepared to meet your needs?
In fact, a valuable way to judge the relative readiness of these outsourcing markets to meet supply chain strategists’ needs is the ratio of 4 or 5 rankings to 1 or 2 rankings. This ratio shows the number of respondents who think the market is “ready” over the number who think it is “not ready”. For the eight different supply chain outsourcing markets we asked about, the range of “ready”: “not ready” ratios was quite wide:

- 6.97 Transportation
- 4.05 Configuration & Fulfillment
- 4.01 Postponement
- 3.36 Factory Supply
- 2.39 E-commerce
- 1.94 Repairs & Returns
- 1.94 Spares
- 1.43 Product Design, Manufacture & Assembly

Three markets represent a solid second tier of outsourcing providers, each with around 20% of respondents saying they are fully ready. These were the configuration & fulfilment market, the postponement market and the factory supply market. In each of these cases, the share of respondents calling these markets “unacceptable” was quite small (<5%). Although respondents were less confident about the outsourced e-commerce market, they still had a big gap between those calling the market “fully prepared” (16%) and those calling it “unacceptable” (6%).

The repairs & returns and spares outsourcing markets were both barely in the black confidence-wise with near ties between “fully prepared” and “unacceptable”. In terms of value chain ecosystem design, these numbers say that all supply chains will look at transport and expect to find solid third party providers. Many will also look to configuration & fulfilment as well as postponement providers with high expectations. Few believe they can build repairs or spares processes around third party outsourcing and plenty worry that product design, manufacture and assembly has problems.

Comparing data for open vs. closed supply chains perspectives on outsourcing market readiness, it is clear that open supply chains see a better landscape for everything, from factory supply which they heavily favour (24% say it is fully prepared against only 17% of closed supply chains) to product design. The only outsourced supply chain market seen by both open and closed supply chains in a similar light is transportation, clearly the most evolved and well understood of all.

Strengths and Weaknesses of Outsourcing Providers

Readiness to meet supply chain strategists’ needs is a matter of having the right strengths to match requirements that might otherwise have been handled in-house. To understand what these evolved markets were doing right, we asked what market leaders brought to the table. At the top of the list were technical competence, meaning ability with systems, tools and technologies, and reliability of execution. In both of these cases clear majorities agreed that outsourcing support market leaders overall offered both technical competence and reliability of execution. Lower down as strengths, but still clearly important were competitive prices and market knowledge. This top layer of strengths that leaders bring to market summarises the core value proposition of outsourcing: “we’ll do it reliably and competently at a reasonable cost around the world”.

Note, however, that cost containment comes decidedly behind the ability to do the job, reflecting the primary purpose our supply chain strategists focus on that which enables revenue growth.

Two areas emerge as shaky strengths, global footprint, which many agree is a strength, scores significantly behind most other areas. The data may show that some players, notably in global transport, really can claim a global footprint. DHL for instance, was mentioned 80 times by respondents in an open response question asking for names of known leaders, while most were mentioned by 10 or fewer and only one other (UPS) was mentioned more than 40 times. Across other outsourcing markets, however, it may be that global footprint is much less common.

The other somewhat shaky strength revealed was agility, defined as problem solving in a short time frame. While most, at least, partially agreed (54%) that this is a strength of outsourcing market leaders, the results are far from unanimous. That agility is not really ready for prime time should not surprise given what it implies in terms of information visibility and decision making.
processes, but considering how aggressively the term is marketed, buyers should certainly be aware.

Relative weaknesses in the eyes of buyers include the higher level of problem solving, labeled strategic competence in this study. Among all strengths studied, strategic competence scored lowest with under 14% of respondents strongly agreeing that market leaders can bring it to the table. As with the often heard pitch around agility, strategic competence is the kind of benefit providers want to offer and buyers love to see, but too often fails to meet expectations. Our data suggests that strategic partnership among your outsourcing providers is more often a hope than a reality.

Also troubling is the low score respondents gave to the notion of intellectual property protection. Only one in six people would strongly agree that even the market leaders could be credited for their reliability with IP. This reflects concerns seen elsewhere in the study that show IP as an important problem for value chain ecosystem design.

Where open and closed supply chains differ, we again see a strategic fork in the road. Closed supply chains care more about IP protection and are more appreciative of market knowledge than are open supply chains. This reflects both the tighter design, technology and market strategy collaboration important to closed supply chains and the higher value they place on additional information inputs to the value chain. Open supply chains, in contrast, are happier with the agility offered by outsourcing leaders than closed are and absolutely love the reliability of execution that leaders bring to market. In fact, only 1.1% of open supply chain respondents strongly disagreed with reliability of execution as a key strength. Open supply chains favour getting the job done while closed supply chains seem to care more about learning as they go.

**Mature Outsourcing Markets – Specific Strengths**

We did drill into which specific strengths shine most brightly for leaders in each of the sub-markets investigated. By asking respondents to assess the strengths of only those markets they classified as “ready” (4’s and 5’s) we isolated what they like about each. Figure 10 highlights that transportation is obviously a very established market built on the key benefits of lower variable cost (77%), lower capital cost (66%) and speed (62%). Similar profiles emerged for postponement; configuration & fulfilment; and factory supply. Each emphasises lower variable cost as the leading benefit seen by buyers with speed as an especially valuable benefit of postponement. None of these saw much of a role for technology mastery as a key benefit.

E-commerce revealed a very different profile for buyers who placed at the top of the list technology mastery (71%) as key benefit vs. lower variable cost (59%) and lower capital cost (43%), which they saw as far less important here than in transport for instance.

Respondents were also given a free form opportunity to identify the typical characteristics that outsourcing leaders bring to their markets. Far the most common mentions were around three key traits: flexibility, reliability, and competence. The comments of one respondent were typical of this perspective:

“Reliable, flexible, technically competent and market savvy; [we are] able to work together where the market is changing, leverage strong business relationships to be more creative and competitive.” In another free form question, respondents were asked to name any outsourcing partners they considered leaders in any market. The answers were somewhat surprising. Obvious established players in transportation and logistics fared extremely well, but next highest were a group of companies known more for design, manufacturing and assembly – the area our data shows is least mature and most inappropriate for outsourcing.

Interpreting these results suggests a split between the big, established global logistics providers whose transportation offerings are well known and widely used, and a handful of leading contract manufacturers dealing in the most challenging areas of product design, manufacture and assembly. In each of these two markets, outsourcers win business with the ideal value proposition of technical competence as a basis for reliable
service which brings business flexibility to customers. The common thread across these brand leaders could be their ability to deliver what many customers say they want, but generally cannot find: solution partners. It is also interesting that on this list the only name not clearly linked to either logistics or contract manufacturing is one many would classify as a true solutions specialist: IBM.

**Immature Outsourcing Markets – Specific Weaknesses**

For respondents who identified a market as “not ready” (1’s and 2’s), we asked about weaknesses that may have earned each market its low grade. The weakest market overall was product design, manufacture and assembly which, as we saw above had a “ready”：“not ready” ratio of only 1.43. Its chief weakness is poor IP protection (59%), but it was also cited as suffering from poor strategic coordination (53%) and unreliable execution (51%). It also had by far the highest score for too few providers and too little market information (44%) among all markets. Repairs & returns is another weak market dogged by poor process coordination (59%) and unreliable execution (59%). Spares similarly, was downgraded for its poor process coordination (57%).

![Figure 11: For those you consider “not ready”, what are their weaknesses when it comes to meeting your needs?](image)

These notable weaknesses leave an opening for outsourcers to enhance their value to customers by better bundling capabilities to address problems in both strategic and process coordination. There is also a need for stronger communication and information integrity, to assure both security of IP and understanding among customers of what services are available. Bill Black, SVP of Quality and Supply Chain for ABB, for instance, says of this problem:

**THE SPOTLIGHT ON ABB**

*Bill Black, SVP, Quality and Supply Chain OPEX, ABB*

ABB’s approach to outsourcing revolves around retaining as much flexibility as possible. “Like many companies, we are most comfortable outsourcing what is perhaps the easier stuff, in manufacturing for example”, bill continues. “As a business, we can’t afford to be capacity-constrained so a significant percentage of our manufacturing activity is outsourced to third parties, with approximately 60% of our total cost of goods sold coming from suppliers”.

The same principle applies, increasingly in engineering as well, with ABB using third party vendors where capacity constraints would otherwise apply. However, moving along the value chain into areas closer to the delivery and service end, it is evident that there is a greater focus on in-house delivery. “We may of course outsource the execution of certain project elements for reasons of capability as opposed to capacity, for example, when it comes to site works and buildings.

We are not the experts and here we call in civil engineers and construction partners”. Further, service is seen more and more as a key differentiator in securing customer loyalty and so is preferably an internal operation. “There isn’t a heavy servicing requirement on many of our products. Once we install large power transformers or gas insulated switchgear, nothing tends to go wrong over the lifetime of the equipment. We do, however, like to maintain a close relationship with our customers to identify any potential future sales or upgrade opportunities”.

When it comes to barriers to outsourcing, as well as the traditional concerns of people around protecting jobs, quality and so forth, bill believes a greater challenge lies with market knowledge. “A lot of outsourcing companies have not adequately marketed what they do” says bill. “A few companies have really opened my eyes as to what they are now doing to support other businesses, but the fact is if they don’t tell us, we won’t ever know what they have to offer”.

And this is why the ‘partnership’ element of the relationship is so vital. “Partnership is the key word; that’s what we’re looking for. We expect to work with partners that are technically competent, highly experienced and with a good track record for reliability”. And all of this at a reasonable price of course. “When it comes to validating the degree to which the relationship has succeeded, our metrics are.
“A lot of outsourcing companies have not adequately marketed what they do. A few companies have really opened my eyes as to what they are now doing to support other businesses, but the fact is if they don’t tell us, we won’t know what they have to offer.”

By combining capabilities into solution offerings and articulating how services are best used, outsourcers will be forced to think in terms of process and strategic coordination.

Open vs. Closed – Different Appetites for Supply Chain Outsourcing

Netting out supply chain strategists’ views on outsourced support markets, it is clear that all view transportation as a mature, robust area capable of meeting the core value proposition of doing the job better, faster and cheaper than in-house. Postponement and configuration & fulfilment both offer natural outsourcing opportunities that are substantially less evolved, but promising both to open and closed supply chain strategies. Factory supply is undoubtedly appealing for open supply chains but much less attractive to those looking for tighter value chain collaboration. E-commerce is an appealing outsourcing opportunity but will live or die based more on technical mastery than price. Repairs and spares both appear too small and immature to attract serious attention from supply chain strategists looking for outsourcing partners. And finally, product design, manufacture and assembly is an outsourcing market with attractions for open supply chains, but concerns over both IP protection and process coordination that are particularly troublesome for closed supply chains.

Supply Chain vs. Manufacturing – Outlooks on Strategy

With 859 respondents around the world and across industries, our survey data allowed us to look into not only the question of “open” vs. “closed” supply chain strategies overall but whether these strategies were more or less likely to align with organisational ownership of value chain functions. As seen in figure 12, what emerged was a surprisingly decisive preference for closed supply chains among respondents who said they had responsibility for manufacturing (53% say “closed” vs. 47% who call their supply chains “open”). Among respondents who said they had responsibility for supply chain, the scales tipped in the opposite direction with 54% calling their strategies “open” and only 46% opting for “closed”.

THE SPOTLIGHT ON McAFFE

Dennis Omanoff, Senior Vice President, Chief Supply Chain Officer & Chief Procurement Officer, who is responsible for Facilities, Corporate Real Estate & Travel at McAfee

At McAfee, the world’s largest dedicated security company, “We approach the outsourcing debate in terms of whether we should ‘own’ the function or ‘manage’ it through outside resources,” Dennis explains. The scale of ‘vertically integrated’ versus ‘outsourced’ has tipped one way or the other at various times. As a rule, however, McAfee focuses on whether outsourcing can add value to the business. How is this done? “First, we always make sure that we’re serving three categories of stakeholders within our business: customers, employees and shareholders. We always keep their interests in mind when evaluating how much of our time should be committed to a particular facet of supply chain operations”.

On this basis, McAfee makes a ‘core versus context equation’, determining to spend its resources on what is considered core to its own business. As a result, McAfee looks for partners that can focus on the contextual nature of the business as their core competency. For example, Dennis recently ran a manufacturing facility that he couldn’t maintain at full capacity. The challenge was to find a potential partner that had a flexible enough workforce that could adjust their staffing models to McAfee’s variations in demand. “It therefore becomes core to our partner and contextual to us”, says Dennis.

Figure 12: Would you characterise your approach to supply chain more as “open” or “closed”? 
At the same time, McAfee has adopted a business model that is highly leveraged and outsourced, controlling the Intellectual Property and design but typically partnering with other organisations, whether for software application, collaboration, assembly of complex products, logistics and so on. Having strategic alignment around the same outcomes is absolutely integral to the relationships McAfee develops with its partners.

“We want to go beyond transactional relationships”, asserts Dennis. “I really want a multi-year, multi-dimensional relationship that is broad and deep in many different areas and where the partner’s management team shares the same vision”. In other words, the more aligned the businesses are strategically, the easier and more successful these relationships become. At the same time, McAfee acknowledges the recognition of mutual interest. “People play up the personal relationships aspect, which is always important, but for me the world in which we live today is very much results-oriented, which means the bottom line is results. We want relationships that get results for our stakeholders”.

To understand this data, we needed first to look at the cross-functional accountabilities in our survey population. Respondents who listed manufacturing as their responsibility also control supply chain 69% of the time while those who list supply chain as their responsibility also own manufacturing only 22% of the time. These results show that manufacturing executives usually control their own supply chain, but that their supply chain counterparts rarely oversee the manufacturing functions they serve. Given this split in organisational ownership, it seems that manufacturing-oriented value chains are more likely to see benefits in a closed than open approach to supply chain strategy.

Manufacturing activities inevitably demand tighter linkages to engineering than do pure supply chain activities, which may help explain why the bias leans toward closed strategies. In fact, as we drill into the data, one of the areas where manufacturing people clearly showed different attitudes toward outsourcing was in the concerns they harboured. As figure 14 shows, manufacturing respondents were much more concerned about intellectual property security than supply chain respondents and also more worried about product quality. Where supply chain respondents showed some higher level of concern was in the area of reliability of cost commitments.
A comparison of supply chain vs. manufacturing The two also differed in their opinions of outsourcing market readiness with supply chain respondents more bullish on all markets than their counterparts in manufacturing. This result was especially clear in emerging outsourcing markets like e-commerce which supply chain respondents classified as “fully prepared” 17% of the time against only 9% for manufacturing respondents. The distinction between these two groups of respondents probably reflects a higher level split between companies whose overall competitive strategy is based on cost competition in relatively undifferentiated markets vs. specialised, higher value positioning in markets with wider gaps between leaders and laggards. In fact, when asked to characterise their supply chain organisation vis-a-vis the rest of the business, manufacturing respondents were substantially more likely to call themselves “an equal partner to sales/marketing/engineering” than supply chain respondents. This indicates that companies favouring closed supply chains are more likely to view manufacturing as integral to their overall strategic position and thus generally set a higher bar for outsourcing partners, especially where institutional learning is at stake.
CONCLUDING COMMENTS

Outsourcing has been around for a long time and supply chain strategies, whether open or closed, are often built, in large part, on it. The role of third party outsourcing partners does differ, however, depending on whether relationships are standards-based, lower risk, largely cost oriented or more tightly integrated, collaborative and information sharing. Most organisations seem to mix some of both open and closed approaches in their supply chain strategies with an eye to cultivating outsourcing partners for each.

The maturity of outsourcing supply chain support markets, however, varies widely from the most established functions like transportation to the most complex and challenging functions like product design, manufacture and assembly. Where outsourcing strategies clearly require more development from vendors is around the coordinating skill sets that allow customers to confidently buy flexibility and technical competence as a solution set, rather than selections from a menu of services. Leaders identified in this research stand out less for their lower costs than for their reliability, a trait equally valued by both open supply chains and closed supply chains. Looking ahead, supply chain functions, including product postponement and configuration & fulfilment, appear to offer the most promise as areas of real incremental value to customers where additional expertise and service bundling might be particularly helpful. Emerging outsourcing opportunities seem to exist in e-commerce which, given some technology and process investment, might attract customers who are less price sensitive and less concerned about customer intimacy than might be assumed. Factory supply is, and remains, a solid outsourcing market, but only for customers looking at an open strategy and willing to work with third party providers to foster standardised and low cost components or materials. Returns and repairs, as well as spare parts management, appear to be too small an opportunity to support robust markets today – these scored lowest overall among respondents as “appropriate” activities to outsource. And finally, product design, manufacture and assembly, although boasting many well respected specialist providers, stands as an area still awaiting significant investment in information management to provide security to customers and coordination across complex, high value tasks. For closed supply chains, product design, manufacture and assembly offers valuable business benefits of flexibility and speed, but demands significant involvement and risk tolerance from the customer.

Recommendations

Outsourcing is not necessarily as simple as core vs. non-core and rarely can be thought of strictly in terms of cost savings. Supply chain strategists should consider potential outsourcing partnerships in terms of whether they reinforce the competitive angle chosen for the business as a whole. Specific suggestions emerging from this research would be as follows:

• Look to transportation for mature providers, but consider expanding the footprint these providers handle in your value chain, especially for open supply chain strategies.

• Dig into the potential for postponement and/or configuration & fulfilment outsourcers to add flexibility to your strategy. For open supply chains, this is probably essential to your competitive strategy and appears to be maturing quickly. For closed supply chains, these services can certainly work, but risks of IP infringement, customer service breakdowns or even product quality problems are magnified by the higher interdependency across the functions of the value chain. This means tougher qualification processes in selecting partners and more hands-on management by the OEM’s staff.

• Factory supply is not only an appropriate outsourcing opportunity for open supply chains, but potentially the highest impact of all in terms of margins. Many comments from respondents to the study highlighted the power of standard component or material selection to improve both cost and quality by sharing development risk for upstream suppliers. Recognise, of course, that this levels the playing field in terms of product differentiation and puts an added burden on functions like fulfilment, repairs and e-commerce to give customers something other than price as enticement to buy. For closed supply chain strategies, outsourced factory supply is generally counterproductive as it reduces product system design advantages.

• Product design, manufacture and assembly is clearly a sticky area for all. Contract manufacturers were among the most commonly recognised “leaders” amongst outsourcing providers and yet it scored lowest overall in terms of readiness to meet supply chain strategists’ needs. In the words of one very senior executive, “they are only as good as their OEM customers”. This suggests that much more needs to be done in this sector to evolve capabilities that go beyond simply lowering costs. Many risks attend this area and yet it continues to attract business. Qualify these providers with extreme prejudice and watch your IP.

• Emerging areas like repairs & returns, spares management and e-commerce are well worth a look, both for open and closed supply chains as all are well downstream from product origination. Providers in these markets appear thin and immature, but interesting, especially if looked at as
bundles of outsourcing services. Expect to provide heavy oversight and direction as this capability evolves.

- Finally, keep in mind that closed supply chain strategies depend heavily on integration – meaning product architecture, new product launch, and fulfilment processes must operate as a stack of closely orchestrated capabilities. This suggests that outsourcing activities upstream is highly risky while those closest to the market are safer. For open supply chains, the opposite largely holds true. Competitive differentiation is often based more on cost control, marketing and sales and agility at the point of sale. Outsourcing farther upstream adds flexibility to the entire system by enhancing substitutability. Be certain where your business is picking its battles before you commit to any outsourcing partnerships. Lowest price may not be the lowest cost.

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