

THE KEYSTONE GROUP

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Middle Market Trends:

Offshore Manufacturing and Sourcing



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Executive Summary

Overview

The Keystone Group's experience working primarily with mid-market companies has indicated that mid-market companies face unique challenges and risks in their offshoring and outsourcing decisions and need to have their own customized criteria and guidelines. To assess the current landscape and better understand how decision drivers have changed in recent years, The Keystone Group conducted a study on middle market trends in offshore manufacturing (offshoring) and international sourcing (outsourcing). Keystone administered a similar survey regarding the state of offshoring and outsourcing in 2014, and comparisons are drawn to the 2014 survey insights, where applicable.

Highlights

While many of the insights and trends from 2014 are still relevant today, recent global uncertainty has driven a need for deliberate long-term strategic planning in addition to cost savings considerations. Overall, companies are expecting to maintain the status quo moving forward, suggesting a more strategic and deliberate approach in a post-COVID environment.



52% of respondents reported a lack of domestic manufacturing capability as a rationale for pursuing outsourcing, up from 26% in 2014.



Companies that took more time in their diligence process were **more likely** to realize their expected savings prior to beginning the project.



Labor costs, tariffs, and freight/logistics were sources of increased costs for **over half** of respondents in both offshoring and outsourcing.



While China remained the most popular location for offshoring and outsourcing, Southeast Asia has become a more popular destination, **up 40%** from 2014.



In the future, **over 70%** of respondents were either unsure or believe we will maintain status quo, compared to 2014 when 56% of respondents expected more offshoring activity.

Keys to Success

Based on these findings, a recommended set of guidelines was developed to assist mid-market executives as they weigh the pros and cons of offshoring and outsourcing.

- **Invest Time Upfront.** Properly assess potential costs and vendors. Set realistic expectations for the timing of the initiative.
- **Build a Contingency Plan.** Know the risks and devise mitigation plans. Assess success regularly and be prepared to go to a plan B.
- **Consider Strategy in Addition to Cost Savings.** While significant cost savings should be an expectation, a long-term strategy will guide better decision making.
- **Global Diversification Can Reduce Risk.** Maintaining multiple options creates agility to respond to unexpected events. Major disruptions and subsequent response tend to be localized by geography.
- **Dedicate Appropriate Management Resources.** Strong leadership is critical to the overall success of the project. The right management team can help navigate the complexities of the initiative.
- **Make Internal Adjustments.** Modify processes to accommodate less transparent and more volatile dynamics. Formalize the planning process and adjust as new obstacles arise.

Introduction

Key Terms

Throughout the article, the following terminology is used:

- **Offshoring:** Overseas or near-shore manufacturing; assembly or production in another country at a facility owned directly or indirectly by the company.
- **Outsourcing:** Overseas or near-shore sourcing; purchasing of product from a non-domestic vendor.

Overview

As manufacturing costs and global uncertainty have increased, there have been several publications assessing whether it makes sense to re-shore production. Many of these publications have focused on the large corporate market. The Keystone Group's experience working primarily with mid-market companies has indicated that mid-market companies face unique challenges and risks and need to have their own customized criteria and guidelines to assist them in their offshoring and outsourcing decisions. To assess the current landscape and better understand how decision drivers have changed in recent years, The Keystone Group conducted a study on middle market trends in offshore manufacturing and sourcing.

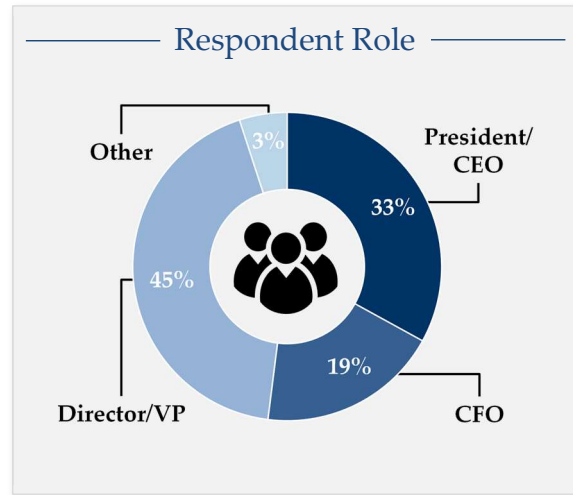
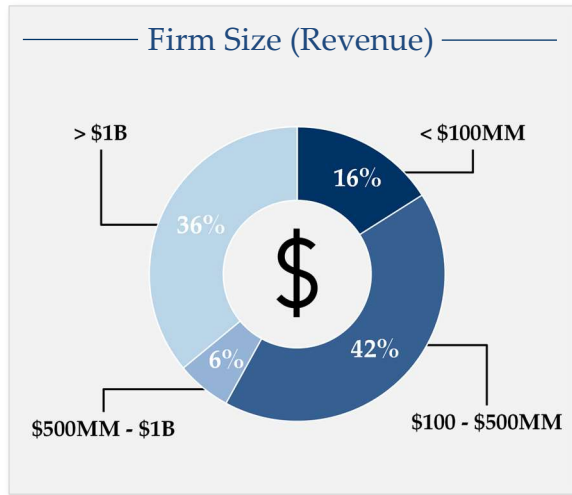
The Keystone Group administered a survey to mid-market C-level executives across multiple industries to gain insights into the future of offshoring and outsourcing trends and the key lessons learned. The goal was to document the current state of mid-market offshoring and outsourcing and to provide mid-market executives with common sense guidance to help them with their offshoring and outsourcing decisions.

The survey was divided into two sections: (1) challenges and success factors in offshoring and (2) challenges and success factors in outsourcing. Executives were asked to answer sections that apply to their specific situations. Based on these findings, a recommended set of guidelines was developed to assist mid-market executives as they weigh the pros and cons of offshoring and outsourcing.

**The Keystone Group administered a similar survey regarding the state of offshoring and outsourcing in 2014. While the insights and recommendations gathered from this survey are reflective of the current outlook, comparisons are drawn to the 2014 survey insights, where applicable. The participants from the 2014 survey are still within our client base, but the respondents to the refreshed survey are not identical and differences in demographic may be a factor when comparing 2014 to today.*

Survey Respondents

The 2020 Offshore Manufacturing and Sourcing Survey polled middle market executives from 14 different industries. Over 90% of respondents were at the Director/VP level or above. Revenues of the companies surveyed ranged from less than \$100MM to more than \$1B in annual revenue.



Industries Represented



Respondent Experience

86% Of respondents have experience sourcing from multiple suppliers and have been doing so for 10+ years

73% Of respondents have experience with multiple offshore manufacturing locations and have been doing so for 10+ years

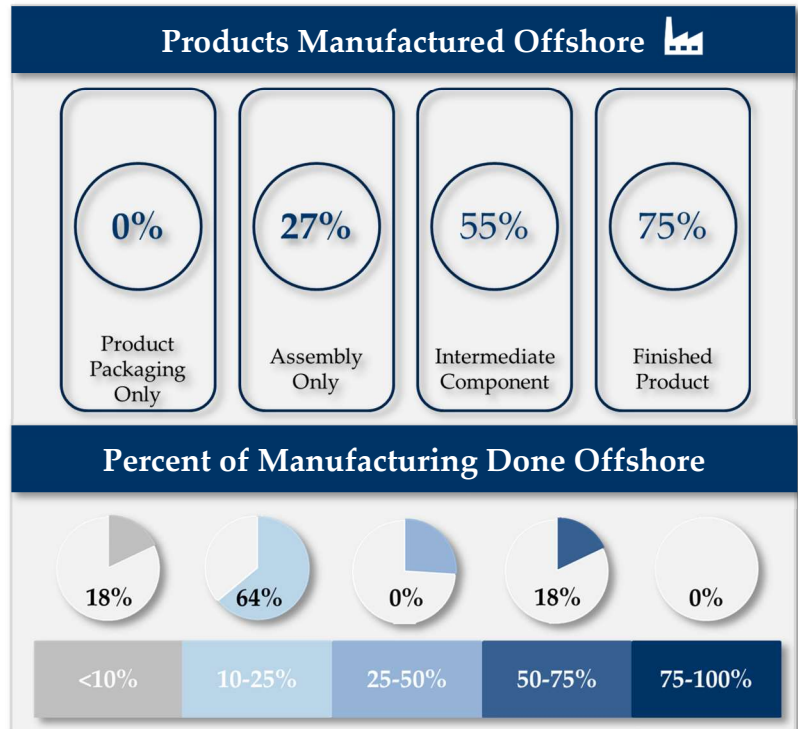
Strategic Planning

Extent of Offshoring and Outsourcing Activities

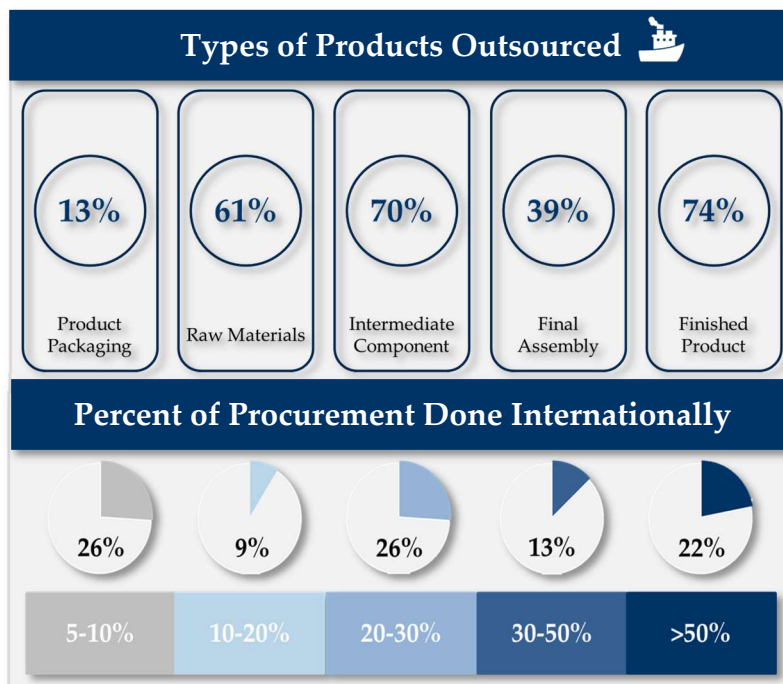
Offshoring

Most respondents (75%) reported manufacturing the finished product offshore, rather than intermediate components or performing the assembly offshore. Of the respondents who did not manufacture the finished product offshore, it was more common to manufacture the intermediate components offshore and complete the assembly domestically.

Almost a third (64%) of respondents reported doing between 10% and 25% of their manufacturing offshore. There was little correlation between the types of products manufactured offshore and the percent of total manufacturing done offshore.



Outsourcing



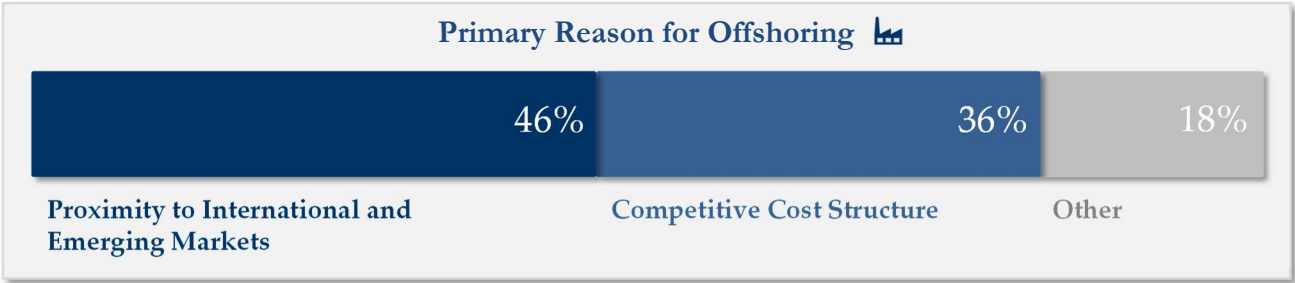
Our outsourcing respondents reported a greater variety of types of products sourced than their offshoring counterparts. Most respondents (65%) outsourced at least two types of products. While 74% of respondents sourced finished products offshore, it was rare (9% of respondents) that a finished product was the only type of product sourced offshore.

International sourcing was of varying importance to our respondent's sourcing strategy. In general, those who sourced only raw materials or intermediate components tended to have less of their total sourcing offshore.

Offshoring and Outsourcing Rationale

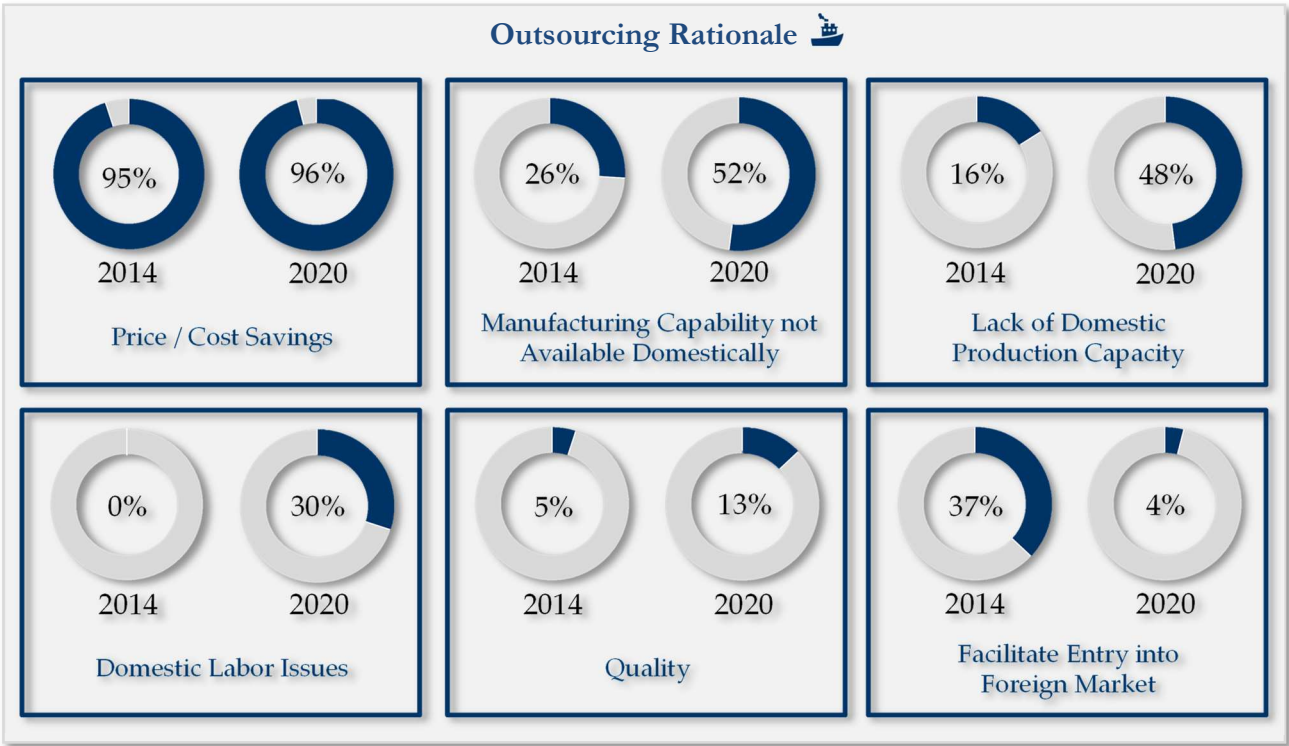
Offshoring

When asked the single primary reason for establishing offshore manufacturing, strategic value played a bigger role for our respondents than cost savings. There is an increasing necessity to be near customers, that is as important as the cost savings considerations. More than half of our respondents included cost of labor, proximity to key customers, and optimal location for supply chain as final criteria for selecting an offshore manufacturing location.

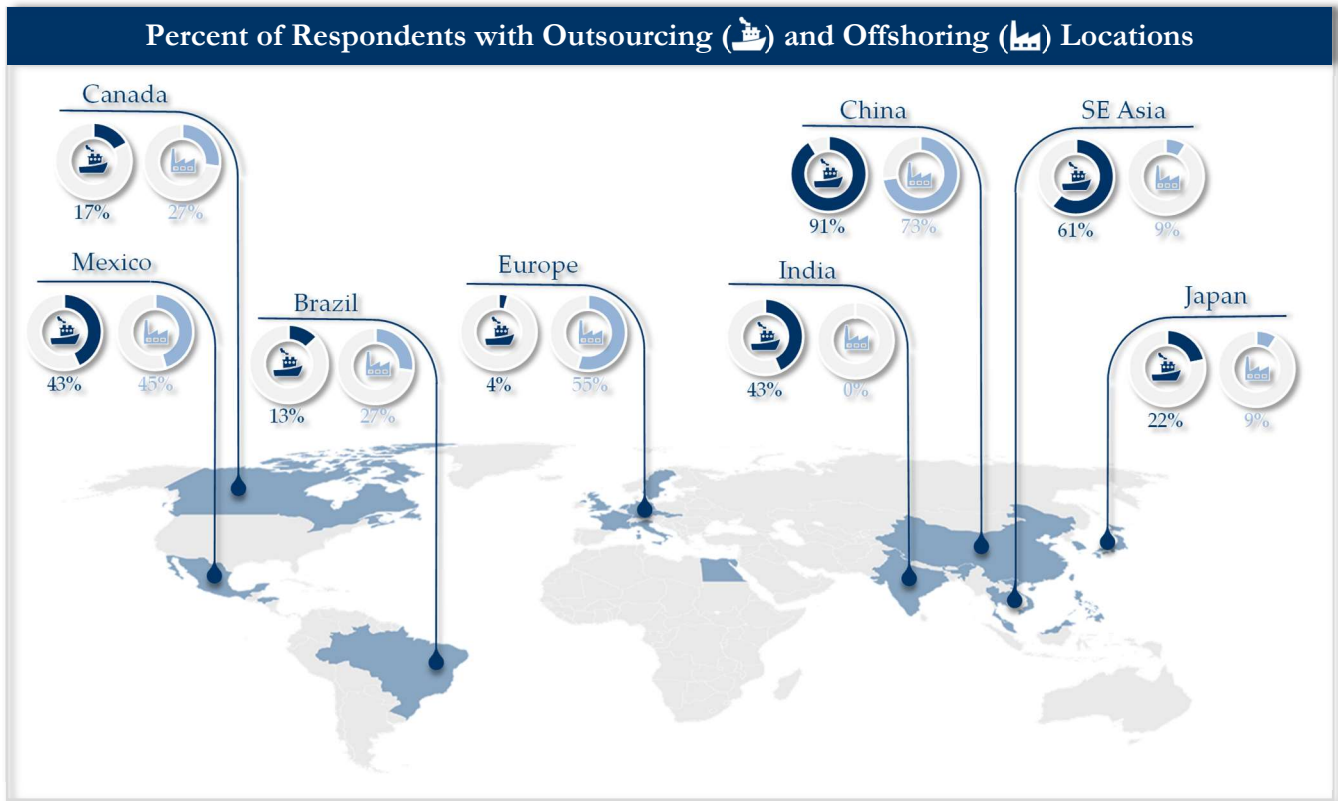


Outsourcing

When deciding to pursue outsourcing, cost savings was by far the most common rationale with 96% of our respondents reporting cost savings as a factor. Lack of domestic manufacturing capabilities, production capacity, and domestic labor issues were all indicated by more survey respondents as a rationale for outsourcing in our recent survey than in 2014. It is worth noting almost no respondents indicated they considered outsourcing to facilitate entry into a foreign market.



Vendor and Location Selection



China remains the dominant force when it comes to outsourcing and offshoring, but Southeast Asia is becoming a more popular option when it comes to diversifying with overseas suppliers (up to 61% of respondents from 21% in 2014). Proximity seemed to be a bigger factor for manufacturing, with near shoring in Canada and Mexico a popular destination among respondents.

Although price and quality will always be considered, most respondents also listed capabilities/expertise and lead time as critical in final vendor selection. Similarly, when selecting a final location for manufacturing, more respondents considered proximity to key customers and supply chain/logistics than the cost of the building. Outsourcing and offshoring is no longer just an option to diversify and save money but has become a necessity to compete in a global economy.

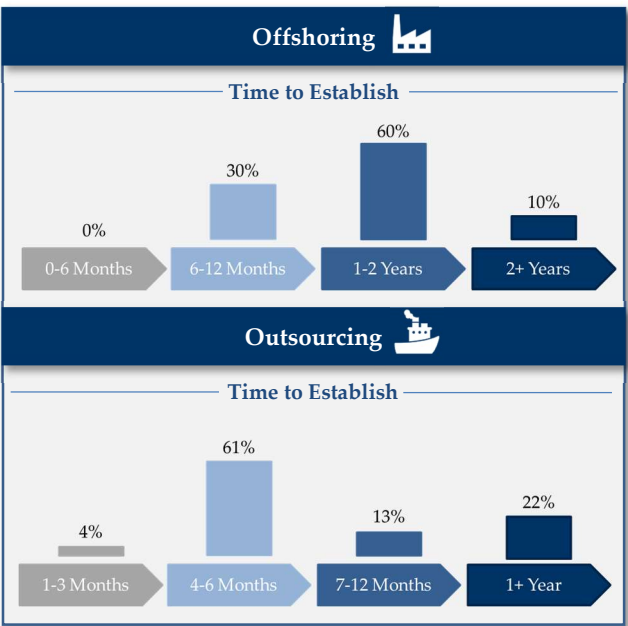


Timing and Benefits

Time to Establish

A significant amount of time is required to establish offshoring. 70% of respondents report taking at least one year to complete the transition, while none of the respondents reported taking less than 6 months to fully establish their offshore manufacturing. For offshoring, we have measured time to establish as time from initial inquiry to having the ability to ship products from the facility.

Based on survey responses, outsourcing can be implemented much more quickly than offshoring. Nearly 80% of respondents were able to establish non-domestic vendor relationships in less than one year, with 65% completing the initiative within six months. The time to establish is measured from beginning the due diligence process to making the first purchase order.



Estimated and Realized Cost Savings

Offshoring



A primary driver for initial offshore consideration was cost savings. The majority of offshoring respondents expected to save between 10% and 30% from the initiative. Nearly all the respondents met expectations, while the balance of respondents realized less savings than expected. In general, those with lower expectations were more likely to meet them. When conducting a similar survey in 2014, Keystone found that respondents in 2014 had a higher level of expected savings but were less likely to realize their expected level of savings, as compared to our recent survey.

In general, the respondents who took longer to set up their offshoring tended to realize more savings. All the respondents who saved more than 20% on their costs took at least a year to establish their offshore operation. While length of time to establish does not guarantee increased savings, companies who take the time to properly evaluate potential options, costs, and establish realistic expectations for the initiative are more likely to realize savings.

Outsourcing

77%

Of respondents realized cost savings of greater than 10%

75%

Of respondents realized at least their expected cost savings

9%

Of respondents reported a lead time increase of 4 or more months

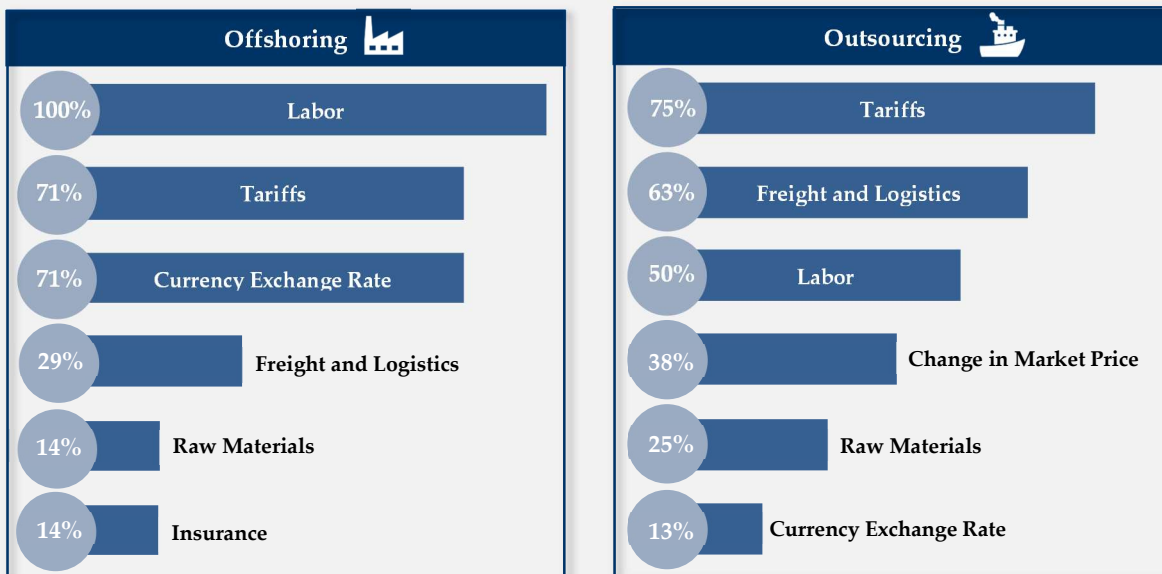
Outsourcing respondents expected to save between 10% and 30% by selecting a non-domestic vendor. Most of these respondents met or exceeded expectations, while approximately one-quarter of respondents have realized less savings than expected. In general, the respondents who took less than 6 months to establish outsourcing were less likely to realize their expected savings. 33% of respondents who took less than 6 months to establish outsourcing fell short of their expected savings, while only 14% of respondents who took more than 6 months failed to realize expected savings.

In comparison to offshoring, respondents realized more savings on average through outsourcing. However, the actual savings realized were more likely to vary from the expected savings when outsourcing as opposed to offshoring.

Cost Trends and Other Obstacles

While many companies were able to realize significant savings both through outsourcing and offshoring, there are still many factors that can lead to uncertainty and cost increases. It is worth pointing out that 100% of respondents experienced an increase in labor costs in their offshoring operations. Moreover, in recent years, we have seen the increasing political uncertainty of some regions drive unexpected cost increases. Overall, our respondents who have offshore manufacturing were more likely to experience cost increases over time (72%) than our respondents who outsource (30%).

Primary Drivers of Cost Increases

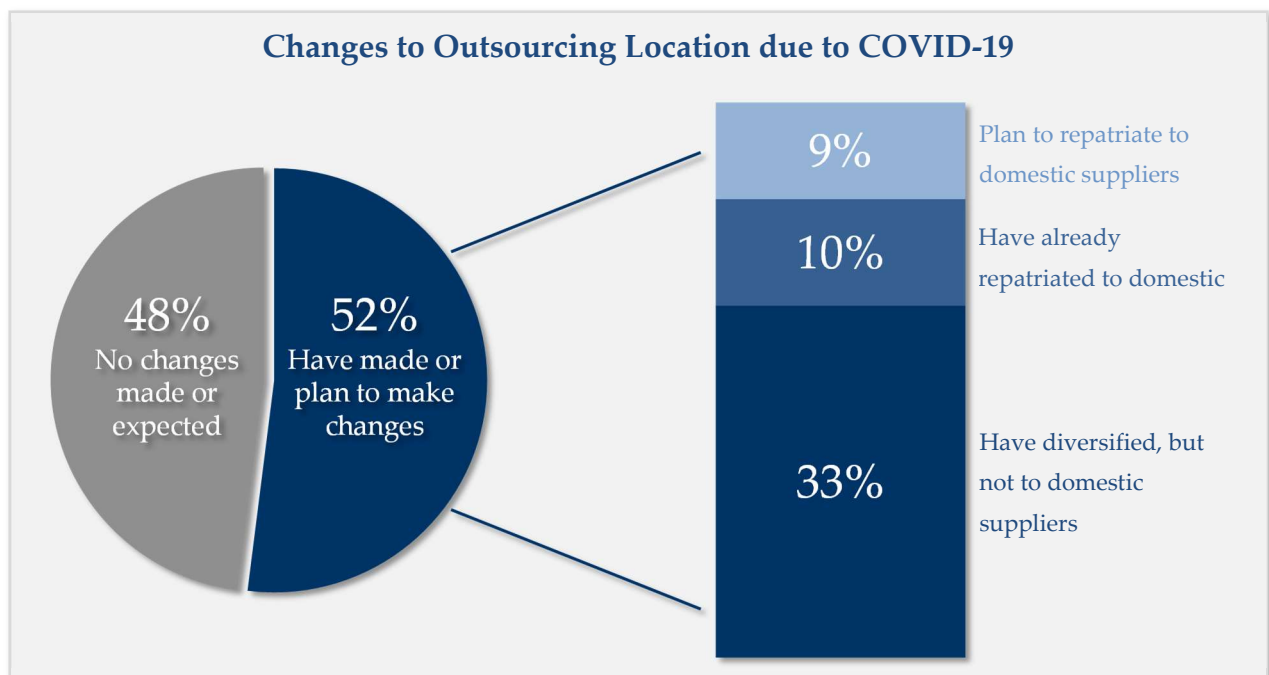


Impact of COVID-19

Diversification of Supply Base



As a result of COVID-19 and tariffs, companies need to be more aware than ever of the risks associated with offshoring and outsourcing. When executed correctly, they can be the source of great savings. However, without the appropriate planning and resources there are major risks that can impact your business. We asked our respondents how COVID-19 has changed their approach to offshoring and outsourcing. While none of our respondents have made any changes to their offshoring operations, just over half of our respondents have made or plan to make changes to their outsourcing. Of those that have made or plan to make changes, most of the diversification will occur internationally.



Looking Ahead

Offshoring



Optimism in 2014 was very high, with more than 50% of respondents expecting more companies to move toward offshore manufacturing. The current sentiment is that companies will maintain the status quo, expecting to continue offshoring manufacturing where it makes sense for them strategically.

"On-shoring to mitigate supply chain disruptions makes little sense to me. There is just as much chance of disruption in the US due to things like Covid as there is in China. Our China operations have recovered much more quickly with less impact to supply."
– CFO at \$1B Manufacturer

Outsourcing



Respondents were more cautious with their approach to outsourcing than they were in 2014. More than 75% of respondents were planning to maintain the status quo, or further evaluate opportunities and cost trends, up from 50% in 2014.

Takeaways



Invest Time Upfront

- Properly assess potential costs and vendors.
- Set realistic expectations for the impact and timing of the initiative.

Those who invested more time upfront were more likely to achieve targeted savings.



Build a Contingency Plan

- Know the risks and devise mitigation plans.
- Assess success regularly and be prepared to go to plan B.

Recommends one respondent, "Balance the supply chain globally to have alternatives as the business landscape changes"



Consider Strategy in Addition to Cost Savings

- A long-term strategy will guide better decision-making.
- Globalization has necessitated diversification to compete in foreign markets.

"Have a long-term strategic plan to enter the offshore market as opposed to a quick cost savings short-term effort," cautions a respondent.



Global Diversification Can Reduce Risk

- Major disruptions and subsequent response tend to be localized by geography.
- Maintaining multiple options creates agility to respond to unexpected events.

"We need to have alternative sources for key products," notes on VP of Ops. "Dual source in different countries to mitigate risk in supply."



Dedicate Appropriate Management Resources

- Strong leadership is critical to the overall success of the project.
- The right management team can help navigate the complexities of the initiative.

"You need to be present; travel to locations and visit on a regular cadence" says one respondent.



Make Internal Adjustments

- Modify processes to accommodate less transparent and more volatile dynamics.
- Formalize the planning process and adjust as new obstacles arise

"Close management of KPIs and frequent communication enables issue avoidance," emphasizes one respondent.

The Keystone Group

The Keystone Group is a results-oriented management consulting firm. Our small, experienced teams work with mid-market manufacturing and distribution clients to develop strategy, improve operations, restructure finances, and integrate acquisitions. Since our founding in 1991, Keystone has been fostering long-term client relationships based on the tangible results we produce using our expertise and unique work style. Through active client involvement, our Partner-led teams deliver both recommendations and implementation of these recommendations to our clients.

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