Why Offshoring May Not be as Cost-effective as it Used to be

written by Lauri Moon | December 13, 2016

It is no secret that large swaths of the Midwest have seen manufacturing plants shuttered or downsized, but there may still be some light at the end of the tunnel.

(Supply Chain Dive – Rich Weissman: 11-15-16)   Homeshoring, it appears, is becoming more popular as hidden costs outweigh the benefits of sending production out of the country.

But is this trend driven by patriotism or economics?

A recent report from the U.S Bureau of Labor Statistics reveals there are currently about 12.2 million active manufacturing jobs in the United States, with a slight downtick in recent months.

Yet in the past several years, there has been a groundswell of efforts to increase manufacturing in the U.S. by repatriating operations and incentivizing companies to keep production within the country. Count General Electric, Ford, General Motors, Caterpillar and Boeing among the high-profile companies that have returned a portion of their offshore production to the country.

So what drives companies' decision-making process in this regard?

The hidden costs of offshoring. Offshoring may help lower the costs of consumer goods, but for the industrial buyer it often represents phantom cost savings. The costs saved can be easily be offset by the amount of time required to chase overseas suppliers, or other logistical challenges.

Supply chain risk is amplified with offshore suppliers; the greater the distance the higher the risk. The recent issues with Hanjin, and continued consolidation in the shipping industry, are just one such example.

In addition, extended supply chains around offshore providers are often opaque, clouding critical communication links. Meanwhile, a globally rising middle class will drive labor rates higher as they demand higher wages and reduce the primary cost advantage critical in the offshoring equation.

Meager economic growth and shifting economic alliances add to the uncertainty. Once companies begin to hedge domestic inventories to mitigate this risk the economics of offshoring worsen.

Harry Moser, founder and president of the Kildeer, Illinois based Reshoring Initiative, a cost of ownership financial model shows many offshoring decisions are not as effective as they first appear. For the most part, economics rule the day.

"Offshoring has been building for 50 years and companies have built their strategies around offshoring, believing that offshore is cheaper," said Moser.

But looking at the manufacturing pain points of delivery, quality, intellectual property, and inventory position shows a different story, he says. "Companies need to look at the total cost of ownership when making sourcing decisions."

Moser, a member of a long-time manufacturing family, claims to have seen dozens of U.S. companies that had been world leaders in machine tools, foundry, equipment, shoe and textile machinery, all idled due to global economics

"Many were not able to compete with offshore competitors due to foreign exchange issues, a poorly skilled workforce, gaps in training, and high corporate tax rates," said Moser.

A vote for homeshoring. "Increasing U.S. manufacturing is the key to reducing budget deficits, improving employment, reducing income inequality, and maintaining a strong defense," said Moser. "By far the easiest, most sustainable way to increase manufacturing is to reshore, to substitute domestic production for imports."

If a company must remain abroad, though, 'nearshoring' – where companies bring production back to North America from Asia – is still better than the alternative.

“It is better for the U.S. economy if production is brought back to Canada or Mexico,” he said, noting the impact of trade agreements like NAFTA. “Getting it closer to the United States is more advantageous than keeping it in Asia.”

The future of U.S. manufacturing may be brighter considering the trends towards advanced manufacturing and its higher value processes, products and wages. But a lack of highly skilled manufacturing professionals is impacting the potential growth in this sector.

According to recent research from Deloitte and The Manufacturing Institute, the U.S. manufacturing sector has a need for 3.5 million manufacturing jobs in the next ten years. Yet, it is forecasted that 2 million will go unfilled due to the skills gap.

A current movement revitalizing vocational training and a recognition that jobs in the manufacturing sector are indeed good ones may help to close this gap in the coming years. This may be the very boost that the homeshoring movement needs.

(Rich Weissman has more than 25 years of experience in all facets of supply chain management. He is past president of the Institute for Supply Management – Greater Boston, and the recipient of the Harry J. Graham Memorial Award, the highest honor bestowed by the Association.)