

# Outsourcing, supply chain upgrading and connectedness of a firm's competencies

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## ABSTRACT

While planning and implementing outsourcing initiatives, firms often wish to isolate outsourcing to a neatly defined area. However, experiences show that such isolation sometimes fails with detrimental effects for the outsourcing firm. This paper focuses on supply chain upgrading and the connectedness of a firm's competencies. Based on a case study, frameworks are illustrated and managerial implications and further research areas are identified. The paper contributes to the outsourcing discussion with an analytical tool useful for planning and monitoring outsourcing initiatives.

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## 1. Introduction

Many industries have experienced an increasing pressure on unit prices as a consequence of globalization. As a result, manufacturing activities have been transferred to low-cost regions in Eastern Europe and to Asia. This trend has been of interest especially among value-chain researchers in industries such as apparel (Gereffi, 1999), furniture (Fakude, 2001; Kaplinsky, Morris, & Readman, 2002; Kaplinsky, Memedovic, Morris, & Readman, 2003) and shoes (Bavan & Navas-Alemán, 2001; Rabellotti, 2001). These studies have indicated that those firms which outsource their manufacturing activities to external actors shift the focus from product and process aspects to downstream oriented issues (Humphrey & Schmitz, 2002; Humphrey, 2004; Gereffi, Humphrey, & Sturgeon, 2005). The core competence is not manufacturing any more, but essentially all the activities before and after production, e.g. logistics and after-sales service. This orientation has led into development of new types of specialist organizations, the systems integrator (Araujo & Spring, 2006), and new job titles like supply chain integrators (Parker & Anderson, 2002). Thus, value-creation has moved away from manufacturing to downstream activities (Araujo & Spring, 2006) where higher profits are assumed (Wise & Baumgartner, 1999).

There are several reasons for this reshuffling of the value chain: Firstly, the opening-up of the global economy has made it possible for historically isolated countries to enter the world trade arena. These new countries typically have low labor costs. Secondly, efficient and effective transportation and communication systems make interaction and exchange over long distances possible and economically viable. Thirdly, more and more firms adopt global sourcing practices and, thus, gain experience in dealing with international suppliers

(Kotabe & Murray, 1990; Handfield, 1994; Levy, 1995; Trent & Monczka, 2003).

However, outsourcing is often related to problems and unfulfilled expectations (Antonucci, Lordi, & Tucker, 1998; Quelin & Duhamel, 2003; Lacity & Hirschheim, 1993; Fill & Visser, 2000). Various firms have reported negative results, sometimes leading to insourcing decisions (Glass, 2000). As such, we need a better understanding of outsourcing decisions. One potential approach is to analyze outsourcing decisions from a competence-based perspective (Pralhad & Hamel, 1990). This perspective adds to the outsourcing discussion which is mainly cost driven.

The structure of the paper is as follows. In the next section, our case study is presented. Thereafter, we analyze the case using a competence model and a supply chain model. Finally, we develop managerial implications and further research questions.

## 2. Methodology

### 2.1. Research design

Given our aim to expand the concept of competencies, we have chosen a qualitative case study research (e.g. Eisenhardt, 1989; Johnston, Leach, & Liu, 1999; Yin, 2003). The case study approach suits well the exploratory and inductive way of carrying out this research in particular because we are looking at a contemporary phenomenon in a real-life context. Our empirical study aims at illustrating competence change and development.

The chosen case company, which we have given the fictive name Pine Furniture Manufacturer Ltd. (in the remainder of the paper called PiFurMa), is part of a larger research program of longitudinal studies of eight Danish pine furniture manufacturing firms. Even though we observed similar outsourcing patterns and issues in four other firms, PiFurMa has provided the most comprehensive access to the requested data. Compared with other companies that are a part of

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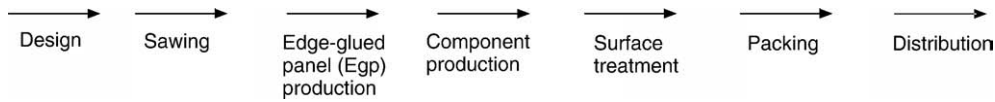


Fig. 1. Pine furniture manufacturing activity chain.

this longitudinal study, PiFurMa is smaller and there are less people involved in the outsourcing process. Therefore, it has been easier to arrange meetings, even on short notice, and to be in direct contact with those key persons that are involved in the outsourcing process.

2.2. Data collection

Data collection for this case study is based on eight personal, semi-structured interviews over a period of two years. The first interview took place in February 2005 when the owner of the firm was interviewed. In the next three meetings in April, May and August 2005, the purchasing manager of the firm and his colleague were interviewed. The following four interviews took place in October 2005, February and June 2006 and April 2007, involving the owner of the firm and the purchasing manager who became co-owner of the company in October 2005. Interviews lasted on average 1 1/2 h and the data has been validated through follow-up discussions with the interviewees and additional printed material.

2.3. The pine furniture industry

Furniture manufacturing was both a resource- and a labor-intensive industry. Manufacturing activities were traditionally carried out by local craft-based firms. Large volume mass-production of furniture became a viable manufacturing strategy in the 1970s when ready-to-assemble (RTA) furniture became more popular. Large scale RTA pine furniture manufacturers often sold their products to export markets where customers were large retailers (Kaplinsky et al., 2003). These retailers were global buyers that compelled the manufacturing firms to produce upon buyers' requests and at competitive prices.

Thus, producing RTA furniture was typically aimed at minimizing procurement and manufacturing costs. Efficient and effective management of the entire supply network was therefore a prerequisite (Bramorski, Madan, Motwani, & Sundarraj, 2000). The major input in the production process of the pine furniture was pine sawn wood (*Pinus sylvestris*), which was transformed into an edge-glued panel (egp) that is a 15–28 mm thick board consisting of lamellas that are 3 cm of breadth and glued together side by side. Many furniture manufacturers had this transformation process done in-house, while others chose to procure edge-glued panels. Panels were then cut and drilled according to design specifications. This was followed by surface treatment, where the components became harder and could be differentiated in colors. The final stage of the manufacturing process was the packaging of a complete set of parts, including assembly instructions and special assembling tools (Bramorski et al., 2000). Fig. 1 illustrates the pine furniture manufacturing activity chain.

In the beginning of 2000, the image of pine furniture changed from good quality natural products, towards low quality discount products. At the same time, many new manufacturers entered the industry mainly located in low-cost regions (Eastern Europe and Asia). Thus,

due to lower consumer prices, lower production costs and over-capacity, the industry faced strong competition.

Danish pine furniture manufacturers were heavily challenged by these developments. The Danish producers were traditionally dependent on few international buyers and their products were tailored upon customer requests without any manufacturer branding. Competition was twofold: On one hand, the competition was fierce among the Danish manufacturers because products and customers were to a large extent the same. On the other hand, Danish manufacturers competed against other regions, in particular low-cost regions.

2.4. Development of Pine Furniture Manufacturer Ltd. (PiFurMa) until 2005

PiFurMa was established by its current owner in 1979 and is situated in Denmark. At that time, PiFurMa was a subcontractor for other Danish furniture manufacturers providing them with individual parts and components. In the late 80s, PiFurMa started producing complete furniture, e.g. beds, dressers chest of drawers and tables. By 2005, the main products were untreated (i.e. without surface treatment) chests of drawers at the low end of the quality scale. The products were mainly sold to a large mail-order retailer in Great Britain (hereafter called UniKing) who accounted for over 80% of PiFurMa's turnover.

The production of these chests of drawers was based on UniKing's product design. UniKing forwarded the product design, and PiFurMa translated the product drawings into production instructions that suited PiFurMa's production facilities. The main material in the production was sawn pine wood which accounted for 65–70% of the total costs. The fronts and top of the product were made of edge-glued panels which were purchased from an Eastern European supplier (East1). East1 purchased sawn pine wood independent from PiFurMa. For their own production, PiFurMa purchased sawn wood from a Swedish supplier (SweWood) which was used for the remaining parts of the product, i.e. the sides, the rear and the drawers. PiFurMa produced the furniture components (sawing, drilling, and finishing). Thereafter, the parts were assembled and packed in cardboard boxes together with fittings and assembling instructions. Due to limited stocking facilities, PiFurMa employed a "produce-upon-order" policy. UniKing assumed responsibility for transportation and logistics. The division of labor is illustrated in Fig. 2.

During the 1980s and in the early 1990s increasing demand on pine furniture resulted in further PiFurMa investments in enlarged production capacity and growing number of employees. Increasing production volumes meant an increasing amount of sawdust, which was an excess product from furniture manufacturing but a valuable source of revenue. With the aid of sawdust the local utility firm was able to ensure the stable supply of district heating to the residents.

With growing demand, new entrants started producing pine furniture. This made it convenient for the global buyers to request the

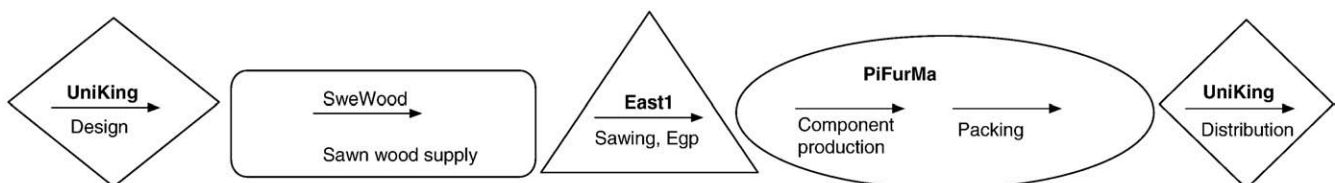


Fig. 2. Value chain for PiFurMa in 2004.

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