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Captive Operation or Outsource? *That is the Question*

It is a question regularly debated in executive strategy sessions and corporate board rooms. Ever-increasing concerns over environmental liability coupled with the desire of many manufacturers to focus on “core competencies” have led many

to consider jettisoning captive finishing operations (finishing departments run on-site as opposed to contracted to an outside finisher) in favor of outsourcing. In weighing the pros and cons of such a decision, several factors come into play. Assuming the decision to outsource is finalized, selecting the right partner will make all the difference.

The most critical step in deciding whether to outsource is to accurately capture the total cost of operating a captive finishing department. Many begin by focusing on direct costs - items like direct labor, chemistry, materials, utilities costs and so on. However, such an analysis is too simplistic. Management must also consider the costs of environmental compliance, technical support personnel, equipment maintenance and depreciation.

What's more, the soft benefits of outsourcing must be analyzed. Items to consider include:

- The opportunity cost of floor space. What could replace the finishing operation that might produce more value or reduce real estate costs in another area?
- The potentially huge costs of an environmental incident.
- The benefits of transferring the focus of many skilled employees to areas of the business that are more closely aligned with the core product.
- The benefits of redeploying capital to other parts of the business.

To be sure, in-house finishing operations offer specific advantages. I spoke with Mitch Isenberg, Senior Environmental Manager of Master Lock, Inc. Master Lock has operated a captive metal finishing department in Milwaukee, Wisconsin for years, a department which Isenberg managed directly for some time.

“Cost is a huge driver,” said Isenberg of the logic

supporting keeping finishing captive. “If you are able to produce in-house at a total cost below that of outsourcing there is an obvious advantage.”

Isenberg also listed turn-times, employing people in the community in which his company operates and the ability of the internal department to participate in research and development activities as key benefits of a captive plating operation.

Sunk capital, access to on-site finishing expertise, control over product quality and ease of scheduling are also often listed as advantages of operating a captive finishing department.

Of course, there isn't one right answer to the captive / outsource dilemma. As an outsource finisher myself I willingly concede that outsourcing a captive shop is not the best alternative in every situation. In the end, companies must consider the importance of the captive shop to the execution of their overall business strategy in making the proper decision.

Assuming that the election to outsource is made, the choice of the proper outsource partner is absolutely critical.

Wisconsin's Badger Meter, Inc. outsourced its metal finishing operation in 2004. Charlene Cechvala, a key player in the company's purchasing department, was closely involved in the selection of the outside supplier. It was important to Cechvala for Badger Meter to find a partner that approached the relationship as more than just supplier – customer. “We wanted an outsource finisher that viewed itself as our off-site finishing department. We knew we needed quick turns and flexibility, but it was also important that our partner have a high level of sophistication and process specific knowledge.”

Cechvala noted that the company to which the work was outsourced had a solid environmental record, programs and systems to ensure environmental compliance and a willingness to customize business practices and processes to Badger Meter's needs.

Other criteria to include in the selection of an outsource partner are:

- Proximity of the partner's facility to the location at which the parts are manufactured.
- Whether the partner's market strategy emphasizes a focus on large projects.
- MIS sophistication, electronic order tracking and

the ability to engage in electronic data transfer.

- Experience in integrating similar projects. There's no substitute for the lessons learned in large project integrations.
- The partner's financial stability since choosing a partner that later goes belly up will create some major problems.
- Technical expertise and the ability of the partner to assist in product design and engineering activities.
- Willingness on the part of the partner to station a representative inside the former captive's manufacturing operation to ensure smooth on-going communication.

The decision to outsource a captive finishing operation is ultimately a strategic one. Proper and complete analysis of the benefits and risks associated with a captive shop must be considered in detail before making such a decision. If and once the decision to outsource is made, the selection of the right partner will make or break the success of the outsource program.



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