Research Guide for Optimizing External Manufacturing Strategy

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Initiatives: Manufacturing Operations Strategy and Performance

With today’s volatility and uncertainty, organizations seek strategic partnerships with external manufacturers to mitigate risk and pursue long-term joint value creation. Supply chain leaders should use the research listed here to optimize their approach and strategy for external manufacturing.

Analysis

External manufacturing (EM) (often referred to as contract manufacturing, outsourced manufacturing or third-party manufacturing), is utilized across industries and geographies in an array of product areas. The coronavirus pandemic of 2020, global trade tensions, climate change and other forces, in conjunction with digital business initiatives and changing business models, have led to a fundamental shift in the requirements of brand owners — the buyers of EM services. With these shifts, brand owners have become more dependent on their manufacturing service providers in many cases, engaging them for a variety of adjacent services in addition to core manufacturing activities. In response to the global health pandemic, many buying organizations have sought proactive advice and support from external manufacturers, seeking alternative production locations, risk management tools and proprietary and/or novel approaches to business continuity management and cost optimization. In tandem, third-party manufacturing service providers have diversified away from commoditized, low-margin manufacturing and testing, and into additional product and service areas, including design and development, supply chain services, software solutions, consulting services and many others.

Relationships between brand owners and EM service providers are progressing in terms of symbiosis and mutual dependency like never before. Historically, EM was driven by tactical pressures including cost savings, the need to fill production and capacity gaps, and a desire to reduce fixed assets and risk exposure. Gartner research has shown that as relationships evolve over time, the elements of strategic partnerships begin to form. As relationship maturity progresses, we observe the emergence of long-term contracts (e.g., master service agreements [MSAs]), mutually-agreed-upon measurements and key performance indicators, and the co-development of a portfolio of goods and services that is designed to drive digital business growth.

Today, savvy brand owners are reexamining their EM strategies, in relation to their strategic enterprise-level objectives, and are devising ways to foster long-term strategic relationships with certain supply
chain service providers where appropriate, with joint value creation and long-term, symbiotic relationships in mind. Figure 1 highlights key focus areas for consideration in crafting and refining a strategy for external manufacturing management, governance and optimization.

**Figure 1: External Manufacturing Strategy Focus Areas**

These evolving relationships and the related maturity progressions have important pragmatic implications for brand owners, the buyers of third-party manufacturing services. In essence, recognizing these trends and acting accordingly can engender a long-term strategic advantage, while a failure to harness the emerging potential will contribute to a decline in strategic positioning. Not all EM engagements are designed to be strategic in nature, and some will necessarily be focused on transactional drivers such as filling capacity gaps. However, supply chain leaders should consider the strategic advantage that EM relationships may present. Additionally, brand owners should develop internal skill sets, talent and competencies needed to harness innovation, reduce risks and optimize costs through EM engagements.

**Research Highlights**

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Supply chain leaders responsible for optimizing manufacturing operations strategy and performance should use the research items to support EM activities and remain competitive by capitalizing on the following:

- Conduct thorough and effective manufacturing make versus buy decisions
- Understand the ways that external manufacturers help their customers build organizational resilience and respond to disruptions
- Define requirements for external manufacturing services
- Understand the EM marketplace and representative service providers
- Create a request for proposal (RFP) package for EM services
- Evaluate proposals for manufacturing services
- Establish an external manufacturing footprint and build relationships with new service providers
- Structure statements of work (SOWs), service-level agreements (SLAs) and MSAs to clearly define expectations and obligations of the parties
- Assess performance and optimize relationships with third-party manufacturers
- Foster long-term, strategic partnerships in pursuit of joint value creation
- Engage EM service providers to develop strategies for risk management and business continuity
- Develop internal talent and competencies needed to manage increasingly strategic and complex relationships

These supporting research below are ordered sequentially to support the essential processes described above.

**Market Guide for Electronics Manufacturing Services**

The electronics manufacturing service (EMS) market evolves as brand owners seek holistic service options to manage today's volatility and to support new business models. Supply chain leaders selecting EMS should use this research to understand changes in the market and the range of services offered by providers. This Market Guide also provides insight regarding many of the adjacent, value-added activities that EMS providers perform in addition to core manufacturing and testing functions.

**Leverage External Manufacturing Relationships to Mitigate Risk and Build Long-Term Joint Value**

In today's environment, managing strategic relationships with third-party manufacturing service providers will help organizations create long-term competitive advantages. With today's volatility and
uncertainty, brand owners increasingly seek strategic partnerships with external manufacturers to mitigate risk and pursue long-term joint value creation. This research helps supply chain leaders build effective third-party manufacturing outsourcing strategies.

**Toolkit: Scorecard for External Manufacturing Service Provider Performance Assessment**

Designed to be used in conjunction with the advice provided in *Leverage External Manufacturing Relationships to Mitigate Risk and Build Long-Term Joint Value*, this Toolkit highlights best practices for developing service provider scorecards based upon metrics cascaded from shared business goals and objectives. With this Toolkit, supply chain leaders are given a sample format that can be used to measure and optimize EM provider performance. Subdivided into cost, delivery and support, flexibility and ease of doing business, partnership and innovation, quality, and risk and compliance evaluation areas, the metrics contained with this Toolkit represent a sampling of key considerations and should be adapted to fit specific circumstances.

**Optimize External Manufacturing Relationships by Focusing on Internal Talent Requirements**

Specialized skills, traits and competencies are needed to manage strategic partnerships with external manufacturers. Supply chain leaders should use this research as a foundation when developing competency models to manage complex relationships which will support their attraction, development and retention of employees.

**How Resilient Is Your Manufacturing Network After COVID-19?**

Global manufacturing organizations have been lulled into a sense of complacency, prioritizing cost containment and efficiency. With trade disputes, climate change, macroeconomic shifts, natural disasters and global health emergencies, priorities have changed in the face of volatility. This research helps supply chain leaders responsible for operations build greater resilience in their insourcing and outsourcing strategy to respond to disruptions and build organizational resilience.

**Engaging Strategic External Partners to Build Resilience and Weather Disruptions**

Severely disruptive events, such as the COVID-19 pandemic, can halt operations and threaten organizational resilience. In 2020, supply chain leaders have struggled to comprehensively describe their risk exposure, articulate network risk and understand the impact of relationship dynamics with third parties on their abilities to shore up approaches to mitigate disruptive impact. Supply chain leaders should engage strategic suppliers and external manufacturers to mitigate risks, build strategies for business continuity and develop a culture of resilience.

**Build Talent and Competencies to Optimize External Manufacturing Partnerships**

Specialized traits and competencies are needed to manage strategic external manufacturing partnerships. Relationships with third-party manufacturers can be put at risk when organizations fail to
define, implement, and adjust talent management strategies. Additionally, organizations fail to develop career paths for external manufacturing management and governance, jeopardizing employee retention in addition to the organization's ability to unlock deeper value from external manufacturing. Supply chain leaders should develop capability models to manage complex relationships and enact steps to attract, develop and retain employees for more valuable strategic partnerships.

Evidence

This research draws from Gartner's insight into manufacturing operations strategy and performance, data obtained through client inquiry, interviews with clients and other practitioners, and our review of vendor offerings in the EM space.

Document Revision History

External Manufacturing Strategy Guidance for Supply Chain Leaders - 14 May 2019

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