

# Methods of reorganising production

A business may need to reorganise its production facilities as a result of business growth, a changing external environment or revised business objectives. This section explores the following methods of reorganising production:

- outsourcing (subcontracting)
- insourcing
- offshoring
- reshoring

## Outsourcing (subcontracting)

Outsourcing (subcontracting) involves a business hiring an external company to carry out a task that it could do itself.

Imagine you pay a builder to build you a house. It is a complex task and requires many different skills. For instance, the skills necessary to install the electrical cables safely are very different from those needed to connect the home's water supply. As it is unlikely that one person can do all these tasks, the builder will need to hire (or subcontract) work to skilled electricians and plumbers. The subcontractors are paid by the builder. The builder still has ultimate responsibility for ensuring the job is done, and they will also be the only person you pay.

The practice of outsourcing or subcontracting is more widespread than you might think. In fact, it is standard practice for major global clothing brands not to make any of their products at all. The companies use a vast network of subcontractors, predominantly based in Asia, where low minimum wages and poorly enforced labour laws help to keep costs down.

The benefits of arranging production in this way are clear. Building and running factories is expensive and this cost can be passed on to the subcontractor. Also, if there is a downturn in demand, the company can simply end its contract with the subcontractor without having to worry about factory overheads or staff redundancy costs.

The downside is that the use of subcontractors results in a loss of control. As the company does not own the factories, it makes it more difficult to know and regulate what goes on inside them. This has resulted in regular scandals for major consumer retailers. This is especially true in the clothing industry, where subcontractors have been found to exploit workers – particularly young women – in dangerous conditions.



**Figure 1.** Most global clothing retailers outsource/subcontract work to other companies abroad, rather than producing the clothing themselves.

Credit: Roberto Westbrook, Getty Images

## Offshoring

Offshoring is the relocation of a business function to another country. As discussed in the previous section, it is becoming more common for companies to transfer part of their activities to another country. In fact, countries and regions are developing specialised advantages to attract international companies. These include:

- research and development in the UK
- consumer electronics assembly in South-east Asia
- clothing production in Bangladesh
- ICT call centres in India

By relocating some business functions overseas, companies can lower costs and increase productivity. However, it is important to remember that both communication and transportation will be made more difficult by offshoring. Offshoring has also been criticised for unethical practices such as exploitation of labour in low-income countries, including use of child labour, below-living wages and dangerous conditions. Environmental damage may also be more likely when companies offshore, particularly to countries with weak environmental protection laws or enforcement.

## International Mindedness

Businesses that consider offshoring need to be very careful to understand the risks associated with the external environment in the host country.

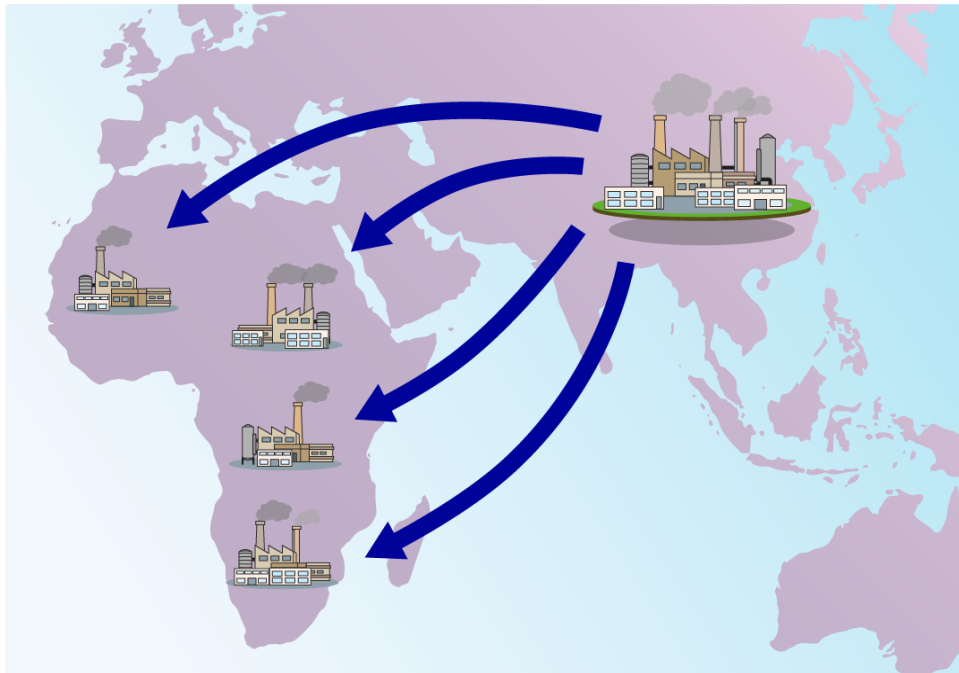
Changing economic factors such as recession and inflation can quickly change the revenues and costs of production. Political instability can make it difficult to predict laws and regulations and can even undermine an entire economy. Changing laws may make it more costly or difficult to operate over time.

While offshoring may be attractive for lowering costs of production at a particular time, it carries significant risks, both financial and ethical, for the business as well.

## Theory of Knowledge

Multinational companies often use outsourcing (subcontracting) in locations abroad to produce the goods they sell. When subcontractors violate laws or the ethical principles the company stands for, for example paying workers too little, the company may be tempted to say that it did not know about what the subcontractor was doing.

- Does subcontracting work relieve a business of its responsibility 'to know'?



**Figure 2.** Offshoring is the relocation of the business function to another location.

### Exam tip

Students often get confused between outsourcing and offshoring. You should remember that when the business outsources, it uses another business to perform activities that it needs for the business. Offshoring involves setting up production in another country.

It is possible for a business to be both outsourcing and offshoring at the same time. When a company like Apple uses production facilities in China through another company, such as Foxconn, this is both outsourcing and offshoring.

## Insourcing

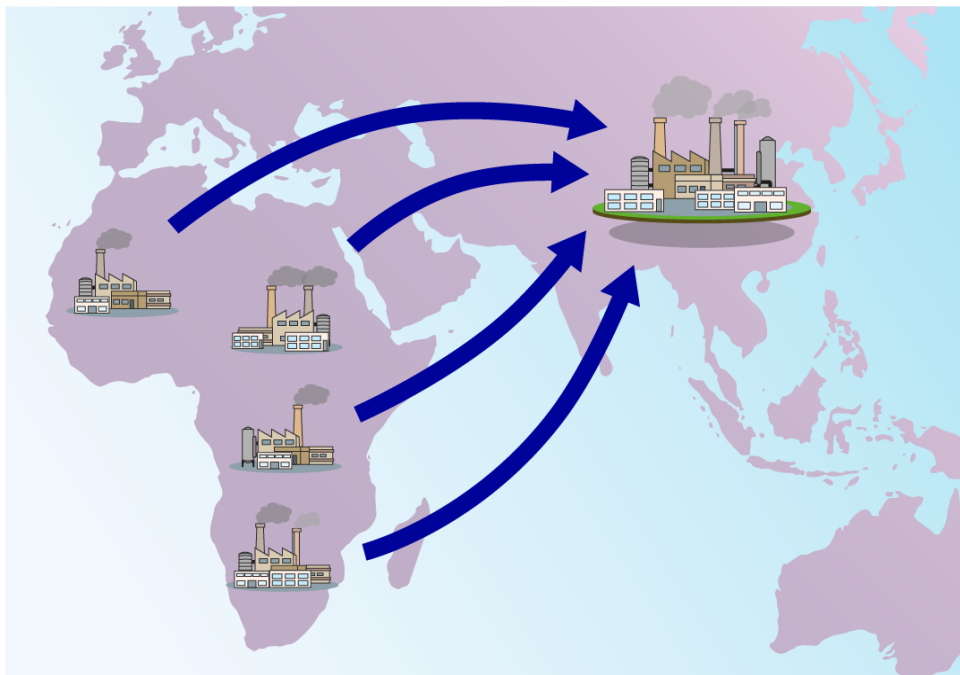
Insourcing involves ending contracts with external suppliers to undertake previously outsourced business functions. Insourcing is the opposite of outsourcing.

Though outsourcing can bring about significant cost savings, it also requires companies to give up a certain degree of control. Outsourcing means that companies place their reputation in the hands of others. Some companies may decide that the cost savings are no longer worth the risk and bring these activities back 'inhouse'. Other reasons for insourcing may include the need to keep hold of commercial secrets, improve quality, or save costs, if the outsourcing did not result in the predicted efficiencies.

# Reshoring

Reshoring involves bringing back production to a country from a location abroad. Typically, this is done so that a business can manage its supply chains more effectively. It enables the business to have more control over production and operations and reduces the risks involved with offshoring. For example, many businesses have decided to reshore production after experiencing supply chain disruptions during the COVID-19 pandemic. While the risk of a pandemic was always there, the reality of it made the financial and operational risks of offshoring even clearer. There could also be country-specific external factors or business-specific internal factors involved in a decision to reshore.

However, reshoring may result in higher costs of production for businesses and could meet resistance from workers. Supply chains would need to be redeveloped, and workers abroad would lose their jobs. These represent significant barriers for any decision to reshore.



**Figure 3.** Reshoring is when a business brings back its operations from overseas.

## Activity

**Learner Profile:** Knowledgeable

**Approaches to Learning:** Self-management skills (organisation)

The text above outlines some advantages and disadvantages of different ways of reorganising production. In this instance, outsourcing and offshoring have been presented together so that a point could be made about the distinction in the terminology. However, when you are studying, you may find that grouping outsourcing and insourcing together, and offshoring and reshoring together makes sense.

- Copy and complete this table in your notes to summarise this evaluative information for your studying.

Advantages and disadvantages of different ways of reorganising production.

	Advantages	Disadvantages
Outsourcing / subcontracting		
Insourcing		
Offshoring		
Reshoring		

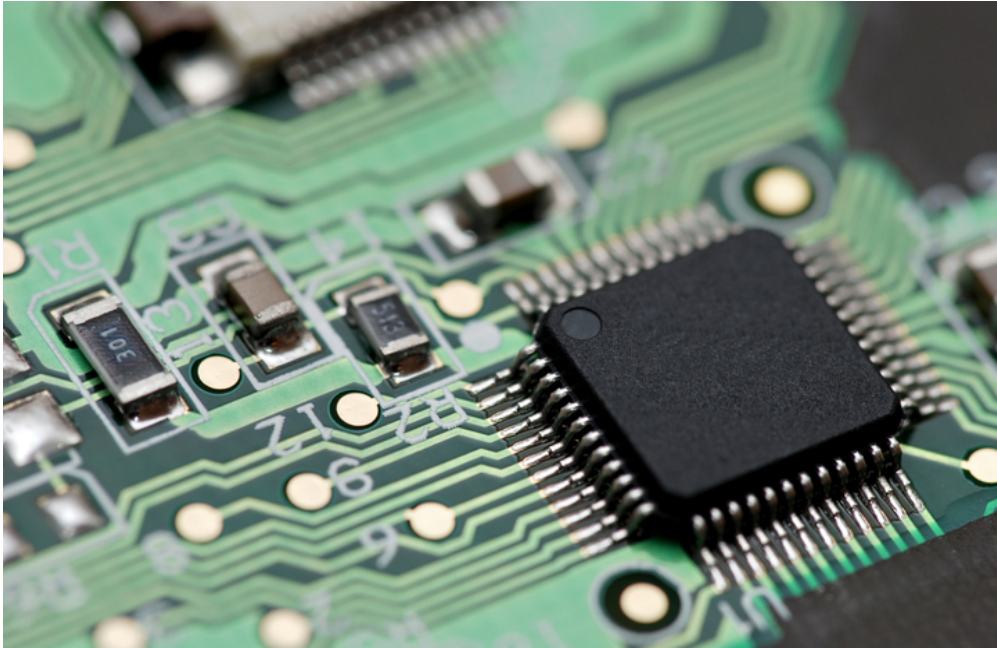
Case study

Reshoring

Disruptions to global supply chains caused by the COVID-19 pandemic, geopolitical conflict and rising labour costs around the world are causing many businesses to consider reshoring their operations to their countries of origin.

For example, Wolfspeed, an American multinational electronics company, recently built a new microchip factory in the United States. This factory can serve the technology needs of other US companies, particularly in the automobile manufacturing industry, who have been facing severe disruptions to semiconductor supply chains from Asia.





**Figure 4.** Reshoring microchip production could alleviate supply chain disruptions in technology industries.

Credit: ilbusca, Getty Images

Governments, understanding how important reshoring may be for production and local jobs, are supporting the reshoring initiatives with funding. For example, the US government has committed 52 billion USD to support factory construction in the microchip industry. This should help alleviate future supply chain problems for industries that rely on semiconductors for their technologies.

However, it is unclear whether the US economy can support growth in this reshored industry. Labour markets are tight, particularly in the skills that workers need for the microchip industry. Wages are rising. In addition, the microchip industry itself depends on a global supply chain of materials. Producing the microchips in the US may not resolve the supply chain problems of Wolfspeed or the other businesses that depend on the company's products, because global markets are so interdependent. Other countries are also trying to increase production of microchips, so that global competition in the future could again drive down prices and make manufacturing in the US unattractive.

### Questions

- Define reshoring. [2 marks]
- Explain two possible disadvantages of reshoring. [4 marks]