

International Business Economics

9. Global Production, Outsourcing and Logistics



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**GOBIERNO
de
CANTABRIA**

Main production issues for international firms

- **Five interrelated questions:**
 1. Where should production activities be located? (concentrated, dispersed and matched with country differences,...)
 2. What should be the strategic role of foreign production sites?
 3. To own foreign production activities or to outsource them?
 4. How to manage the global supply chain?
 5. Should the firm manage global logistics, or outsource the management to specialized enterprises?

The location of production

- Firms may **locate production so they are also:**
 - Locally responsive
 - Able to respond quickly to shifts in customer demand
- Three factors:
 1. Country factors
 2. Technological factors
 3. Product factors

Country factors

- Economic, political, and cultural conditions (**comparative advantages**)
- Firms may consider:
 - Factor costs
 - Economic, political and cultural conditions
 - Skilled labour and supporting industries
 - Trade barriers
 - Exchange rate changes
 - Transportation costs
 - Regulations affecting FDI

Technological factors

1. The level of fixed costs and the **minimum efficient scale**
2. The **flexibility of the technology**
 - **Mass customization** (i.e., Toyota: reducing inventories and responding to diversity demands)
 - Availability of flexible technology facilitates concentrating production in few locations

Product factors

1. The **product's value-to-weight ratio** (transportation costs)
2. Whether the product serves **universal needs**

Hidden costs of foreign production locations

- High employee turnover
- Poor workmanship
- Poor product quality
- Low productivity

The strategic role of foreign factories

- It can change over time
 - (i.e., electronic components for telecommunications in Asia: from low cost labor to advanced design capabilities)
- **Improvements come from**
 1. Pressure to lower costs or respond to local markets
 2. An increase in the availability of advanced factors of production (i.e., infrastructure or education)
- Foreign factories as globally dispersed centers of excellence (rather than just low-cost facilities)
 - **Global learning**

Outsourcing production

- **Make-or-buy decisions** (i.e., components of a car)
- In international markets, decisions involving: political economy, exchange rates, factor costs, etc.

- **Vertical integration:** making component parts in-house. **Advantages**
 1. Costs
 2. Investments in highly specialized assets
 3. Protection of technology
 4. Accumulation of dynamic capabilities (i.e., Apple in product design)
 5. Scheduling of adjacent processes

- Buying component parts from independent suppliers. **Advantages**
 1. Flexibility
 2. Costs. Avoiding:
 - Coordination and control of additional subunits
 - Lack of incentive associated with internal suppliers
 - Difficulties with setting appropriate transfer prices
 3. Orders from international customers

To manage the global supply chain

- **Logistics.** Goal:
 - Efficient global supply chain
 - To establish a competitive advantage

High potential for increasing benefits (i.e. by reducing material costs)

- **Just-in-time (JIT) systems**
 - Cost savings
 - Help to detect the origin of defective parts

But, no stock of inventory

Activity 1

PHILIPS IN CHINA

- Which were the main characteristics of the country at the time the company entered? Which advantages and disadvantages did this imply? Did this condition the strategy of the company?
- Which could be the problems of moving production excessively to China?
- How are the changes in China since the entry of the company affecting it? Which advantages and disadvantages appear?

Activity 2

GE MOVES MANUFACTURING

- “For decades General Electric has been at the forefront of the move to shift production offshore from high-cost locations [...] to cheaper locations”.
- Is this still happening at present?
- Which economic reasons can explain the recent trends on this regard?
- Which advantages obtained GE from moving the production of its water heater to the U.S.?

Activity 3

HEWLETT-PACKARD IN SINGAPORE

- Which comparative advantages saw Hewlett-Packard in Singapur in the 1960s-1970s? Were they based on valuable skills or on low wages?
- Which were HP's productive activities in Singapore in the 1970s? Did this change in the 1980s and 1990s? How?
- Which comparative advantages has HP now in Singapur? Should they move their activity to Vietnam, where wages are much lower?

Reference

- Hill, Charles W. L. (2014): *International Business. Competing in the global marketplace, 10th edition*. Emerald Group Publishing Limited.