Chapter 16

International Production & Sourcing

MNCs are complex phenomena but their ultimate objective is to sell their products to customers, and while other value-chain activities (like R&D and marketing) are certainly highly relevant, the MNC has to provide the goods and services it wants to offer. Sourcing the necessary inputs and producing the right outputs is a complex task that is at the core of a MNC's strategy. In this Chapter, the basic decision between sourcing and production is shortly explained, the configuration of production and sourcing activities is discussed and basic production processes are highlighted. In addition, different types of foreign production plants are described and the main developments in international sourcing explained.

Introduction

The term "production" refers to the value-generating activities that transform inputs into outputs and eventually create products. While this term includes manufacturing and service activities, this Chapter will focus mainly on manufacturing activities, i.e., the production of physical products. "Sourcing" includes all activities that organise the supply of the company with input goods and services that are needed but not produced within the company itself. It usually involves the identification of the required goods and services, supplier selection, price negotiations, etc. Generally, ensuring security of supply of products of an adequate quality and at an adequate price is the main objective of the sourcing managers.

Given that in some industries more than 50 % of the value of the final product stems from externally procured inputs, the relevance of sourcing for the MNC's success is enormous. However, both types of activities, production and sourcing, can be understood to be just different operation modes for the same activity. A first, basic decision of a company refers to the "make-or-buy" question (see Chapter 13). For example, for a car company that needs a lighting component as an input for its final product, the company has to decide on whether it wants to manufacture this component by itself or wants to procure the component from an external supplier. From the perspective of transaction cost theory, this decision merely fixes the level of vertical integration in a "given" production chain, i.e., it just answers the "who" is carrying out a certain activity. In particular with regard to international production strategies, many authors also use the term "sourcing" when referring to "internal suppliers", i.e. other production units of the same MNC. In this
Chapter, however, the term “sourcing” is used for procurement from external suppliers.

Furthermore, it has to be noted that production, sourcing and logistics are three closely interrelated parts of a production system. Parts and components have to be transported from a supplier to the focal company (procurement logistics), they might have to be stored in a warehouse, they are transported to the first stage of the company’s production process and subsequently through the company’s production chain (which might be geographically dispersed) (production logistics or intra-logistics) and finally, products have to be delivered to customers (distribution logistics). Logistics will not be discussed in the Chapter but it has to be considered in the configurational decisions for production as well as in the selection of suppliers.

**Configuration of Production Activities**

**Concentration vs. Decentralisation of Production Sites**

A MNC has to decide whether it wants to carry out production activities in one factory in a centralised location or whether it prefers to decentralise the activities across different countries. For example, Swiss manufacturers of luxury watches, like IWC, often locate all their production activities in Switzerland and serve the world market from there. On the contrary, Japanese car manufacturers started to relocate their production facilities to their target markets in the 1980s and often serve regional markets from regional production sites (see the case study on Nissan in Chapter 5).

Advantages of decentralising production activities into different countries include:

- **Circumvention of trade barriers**: MNCs can save custom tariffs and overcome non-tariff barriers by locating production in the target market.

- **Acceptance by local governments**: Host country governments prefer local production which has benefits for their labour market, trade balance, etc. Often, they are willing to give incentives for locating production in their countries.

- **Easier adaptation to local markets**: Locating production facilities in the target market leads to increased sensitivity for local market needs.

- **Advantages in distribution logistics**: By locating production closer to the markets, MNCs reduce delivery costs to their foreign customers and shorten delivery times. This shortens their time-to-market (which is important, e.g., for clothing companies like Zara, or consumer electronics