

The Economic and Operational Reasons to Outsource Manufacturing in a Recession

In economic downturns, every organization should pause, reflect and evaluate whether the current model is the most efficient going forward. Companies in the healthcare industry, especially firms that manufacture, market, sell and distribute dietary supplements (i.e. vitamins, minerals, and nutritional supplements), pharmaceuticals, and medical devices need to reevaluate the efficiency of their manufacturing operations. Manufacturing healthcare products such as dietary supplements, pharmaceuticals, and medical devices requires a significant capital outlay, technical expertise, and proficiency with regulatory requirements in domestic and international markets. In an economic recession, many healthcare firms recognize that investing such financial and real capital assets is more efficient when applied to the firm's core competency of marketing and selling products.



By M. Amirul Karim

An economic recession is a cyclical business downturn characterized by two consecutive quarters of declining Gross Domestic Product (GDP). Generally, all firms in the economy experience decreased revenue turnover; firms with high fixed operating costs are especially prone to operating losses. Healthcare firms that are engaged in manufacturing their own dietary supplements, pharmaceuticals, and medical devices are especially prone to operating losses in such an economic environment. To avoid such pitfalls, outsourcing manufacturing operations is an ideal solution that embraces several fundamental factors driving business decisions: (1) core competency; (2) opportunity costs; (3) lower fixed operating costs; (4) fixed unit costs vs. variable unit costs; (5) technical and regulatory knowledge and expertise.

All firms should invest in their core competencies. For healthcare firms, the core competency is generally the ability to bring dietary supplement, pharmaceutical, and medical device products to market that effectively improves the health and wellbeing of its customers. The manufacture of such products is a not a necessary prerequisite for achieving the goal of improving the health and wellbeing of customers. Instead, manufacturing healthcare

products internally misallocates financial and real assets away from core competencies, thus violating the economic concept of opportunity cost.

In economics, the opportunity cost is the "loss of potential gain from other alternatives when one alternative is chosen." More specifically, it is the metric by which we decide one alternative over another. For example, if we have a \$100 million surplus, do we build a new factory to produce a given product, or do we spend \$100 million in sales and marketing of our a given product? For healthcare marketers, the answer is almost always the latter, especially in an economic recession. Financial capital for healthcare marketing firms yields a higher return on capital and a return on investment if it is spent to acquire market share and customers.

Similarly, outsourcing manufacturing operations also allows a healthcare firm to lower fixed operating costs by reducing or eliminating factories, equipment, and workers that represent significant financial capital.

Moreover, if a firm outsources manufacturing to a third party, their variable unit costs--the variable cost of sales that fluctuates with raw material, energy, commodity, and currency prices--transform into fixed unit costs. The third party vendor charges a fixed pre-

determined price per batch, allowing healthcare marketing firms to project break-even and profitability points with more certainty going forward.

Finally, outsourcing manufacturing operations allows a healthcare firm to pass the regulatory and product liability risk to a third party. Compliance with domestic and international regulatory requirements becomes the responsibility of the manufacturer. Additionally, the costs involved in validating the purity, potency and efficacy of dietary supplement, drug or medical device products are also passed to the third party vendor, and are part-and-parcel of the healthcare firms' fixed unit cost. In an economic recession, it is increasingly important for a firm to leverage its core competencies; outsourcing manufacturing enables a firm to focus on building brand equity, growing the customer base, and bringing new products to market, without the burden of managing and paying for large fixed operating costs, highly volatile variable unit costs, and passes the responsibility of regulatory and technical risk to a qualified third party contract manufacturing organization. Thus, in an economic recession, if we use the fundamental economic concept of opportunity cost, the answer is clear: outsourcing manufacturing is the only choice for a healthcare firm. ■

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يجب على كل مؤسسة في فترة الإنكماش الإقتصادي أن تتوقف وتفكر وتقيم فعالية نموذج العمل الحالي الذي تتبعه. ويتوجب على الشركات العاملة في صناعة الرعاية الصحية كمصنعي وموزعي للملحقات الغذائية والأدوية والمعدات الطبية أن تعيد النظر في فعالية عمليات التصنيع لديها. يتطلب تصنيع منتجات الرعاية الصحية هذه إنفاقاً مالياً كبيراً وخبرة تقنية وبراعة بالإضافة إلى ملاقات المتطلبات الرقابية في الأسواق المحلية والعالمية. خلال الإنكماش الإقتصادي يدرك العديد من شركات الرعاية الصحية أن استثمار هكذا موجودات مالية يكون أكثر فعالية عندما يُطبق على كفاءة الشركة الحقيقية في تسويق وبيع المنتجات.

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