

Extreme

Is Horizontal specialization killing companies?

outsourcing

BY STEVE TOBAK

Remember the days when ROEMs did everything: systems, software, chips, direct sales, even materials? The corporate bingeing of the 1980s led to a massive hangover, and it took almost a decade of reengineering and downsizing to cure it.

We have since learned that vertical integration is bad and outsourcing everything that isn't a core competency is good, giving rise to the horizontally specialized supply chain we know and love today.

Has the pendulum swung too far toward horizontal specialization? I contend it has. While it's true that vertical integration for its own sake has a way of bloating expenses beyond the realm of profitability, extreme outsourcing can be equally devastating to long-term corporate health. And I'm not even talking about issues associated with moving offshore, such as vendor management, transit and logistics issues, and time-to-market.

At the top of the list is loss of competitive differentiation or value proposition dilution. Then there's loss of leverage: manufacturing and infrastructure leverage, supply chain clout and intellectual-property (IP) leverage. All of this inevitably results in ever-decreasing market share and profit margins.

Consider how some of the top-tier OEMs in the business balance vertical integration



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against horizontal specialization. Cisco, HP, IBM and Sun, for example, all develop a significant portion of the proprietary chips and software used in their systems. They all have services businesses and sell direct. And yet they all engage in outsourcing.

IBM Corp. is a master at this approach. It markets software, chips, foundry capacity, platforms—even IP—to offset operating and capital expenses. And IBM spins off technology that's either unprofitable or not strategic to its core business. Many companies, both large and small, can learn a lot about the vertical-horizontal balancing act from IBM.

Of course, vertical integration is not just for OEMs. Flextronics, the top-ranked global electronics manufacturing services (EMS)

provider, has been acquiring design, packaging and assembly technologies, mostly focused on wireless and handheld systems, and is offering customers fully integrated, vertical solutions. Betting big on this radical approach helped Flextronics differentiate itself from and ultimately outperform its competitors. Now it's an EMS company and an ODM. What's next?

If extreme outsourcing is a concern for you, then get your management team to take a hard look at the logic of your outsourcing strategies. Here are a few questions to pose:

- Are we experiencing erosion of our competitive differentiation, value proposition, market share and/or profit margins?
- Are we losing manufacturing, IP or customer leverage to the supply chain?
- Do we lack the infrastructure to compete with vertically integrated rivals?
- Is outsourcing sacrificing long-term shareholder value to achieve near-term results?

If you answer “yes” to one or more of these questions, then maybe it's time to rethink your horizontal specialization strategy. Your company's future may depend on it. ■

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