Dell Continues its Supply Chain Transformation with Plans to Potentially Sell All Remaining Factories to Contract Manufacturers

Another Poor Quarter, as Company Looks to Further Reduce Supply Chain Costs; Is it Really Less Expensive? The End of "Two Touches?"

SCDigest Editorial Staff

After announcing plans to more aggressively enter the retail channel and shutter a legendary computer plant in Austin, TX earlier this year (see **The New Supply Chain Lessons from Dell**), Dell is currently shopping its remaining company-owned factories, according to a report in the Wall Street Journal.

The move follows another disappointing quarter in which Q2 earnings dropped 17%, from 2007, causing a sharp drop in Dell's stock price as well.

Unlike most computer manufacturers, Dell continues to build most of its own computers, in part to support the "build to order" model that had for more than a decade defined its supply chain greatness – and which the company said it was substantially abandoning in Spring 2008 announcements. It also said at the time it was planning to make greater use of contract manufacturers (CMs).

Dell currently does use Asian-based CMs for first stage production of many of its notebook computers, but the work is actually completed in Dell-owned facilities to add final options, a process Dell refers to internally as "two touch." While the approach added extra logistics and manufacturing costs versus a single touch system, for many years profit margins were fat enough to absorb the hit. But market conditions have changed, both in terms of lower prices and margins and a rapid shift to notebooks, making the two-touch process more of a financial burden than when notebooks were a smaller percent of sales.

Many companies move to outsourced production to reduce fixed assets and fixed supply chain costs, and to increase overall production flexibility. Others decide that they do not want to devote attention and resources to manufacturing expertise.

Most of the rest of PC production is performed in Dell owned factories in Texas, Tennessee, North Carolina, Florida, Ireland, India, China, Brazil, Malaysia and Lodz, Poland. One plant is Austin was closed earlier this year.

Now, Dell is quietly shopping those factories, primarily to contract manufacturers. Key to the interest of those companies would likely be a deal that guarantees keeping the Dell business for some number of years. It is possible that only some of the factories would be sold, and others simply closed under such a program.

Dell competitor HP says it builds less than 50% of its own PCs and laptops, according to a company executive. Many companies in the high tech world totally outsource production.

Is Outsourced Production Really Cheaper?

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ers decide that they do not want to devote attention and resources to manufacturing expertise.

The Dell factories, however, were known for their cutting edge efficiency and heavy use of automation in delivery parts and moving finished goods from work cells. Could the company really save money by moving to an outsourced model?

"Contract manufacturers can generally produce computers more cheaply because their entire operations are narrowly focused on finding efficiencies in manufacturing, as opposed to large firms like Dell, which must also balance marketing and other considerations," the Wall Street Journal piece noted.

In some cases, there can be an immediate short term benefit to the bottom line, as the company can book a profit on the sale of the factories, especially those that have been well depreciated.

It seems likely that in the short run unit costs would not be lower for Dell, and maybe even higher, as the CM's profit margin would also have to be absorbed. However, it would allow Dell to eventually shed or redeploy a significant amount of overhead that is tied up in managing production processes and facilities, and to act more quickly to shifting demand and product patterns in the fast changing high tech world. A substantially greater percent of production could move to lower cost countries.

Underyling the change in part is the background of **Michael Cannon**, president of global operations for Dell. Cannon was previously CEO of contract manufacturer Solectron. At a Wall Street analysts meeting in April, he said that Dell was now committed to leading the industry in delivering equipment "at the lowest total landed cost" anywhere on the globe. "That's what drives our supply chain decisions," he added – and obviously greater use of outsourcing and the flexibility that brings is a key part of that strategy.

At the time, Cannon said these and related moves would reduce supply chain costs at Dell by some $3 billion annually. He also stated that Dell Cannon had "underestimated the capabilities of our supply chain partners" such as CMs in the past.

There are some barriers to the potential factory sell-off. Most CMs operate in low labor cost areas, such as Asia or Eastern Europe, and may be leery of buying plants in the US or Ireland.

Dell has also received some government incentives for plants in the US that came with commitments about employment and investments.