PROVIDING FOR AMERICA'S PASTIME: AN HR SOLUTION OR A THING OF THE PAST?

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ABSTRACT

America's last remaining baseball glove maker has endured bankruptcy, two major fires, and the high cost of American labor. So far, that is. Bad decisions of the past have recently caused a substantial portion of the company to be sold and manufacturing to be shifted. Yet it also has created new opportunities. This case examines the forces that encourage companies to shift manufacturing overseas while shackled by the use of a marketing trait from days gone by: Made in America. Yet, at the center of these strategic choices is the company's prime resource: human capital.

INTRODUCTION

This case discusses Nocona Athletic Goods, America's last remaining baseball glove maker who chose not to outsource or offshore its manufacturing, but rather to maintain its commitment to "Made in America," at the same time establishing itself as a vital economic contributor to the town of Nocona, Texas. Although Nocona has adhered to its patriotic tradition, that very action is the fulcrum of their survival. While "Made in America" could secure the company's existence, the reluctance to outsource could guarantee its failure.

Outsourcing provides companies with an opportunity to utilize the advantages of outside vendors who effectively contribute to the organization and reduce operating expenses. Wise outsourcing choices can provide companies with long-term benefits that otherwise would not be available. For example, "outsourcing converts fixed costs into variable costs, releases capital for investment elsewhere in your business, and allows you to avoid large expenditures" (*The Benefits of Outsourcing*, 2008, ¶ 3). In addition, "every business has limited resources, and every manager has limited time and attention. Outsourcing can help your business to shift its focus from peripheral activities toward work that serves the customer, and it can help managers set their priorities more clearly" (*The Benefits of Outsourcing*, 2008, ¶ 7). Outsourcing also has the potential to negatively affect employee morale; therefore, managers must be equipped with the knowledge and skills to resolve employee resistance to new processes.

Also, as appealing as outsourcing appears on the surface, companies must consider if outsourcing is right for their company before they commit. For example, companies should consider "their expertise in managing remote locations, the caliber and skill sets of the labor force, the cost of labor, language barriers, telecom bandwidth, political stability, enforceability of intellectual property rights and business contracts" (Sturo, 2006, ¶3).

As outsourcing grows, the implications for America are potentially perilous. With fewer manufacturing jobs available and the possibility of white-collar jobs being outsourced, America will reap the consequences of outsourcing through reduced human capital, increased unemployment rates, reduced innovate ability, and product buy-in. Human resource departments will be responsible for strategically managing ways to retain key employees while at the same time downsizing as needed. Displaced workers will have a more difficult time finding jobs and, in many instances, the jobs they find will be in a different capacity and often for less pay (Bybee, 2009). While the final impact that outsourcing will have on America is still unknown, companies will continue to make decisions that best fit their strategy and vision.

The purpose of this case is to strategically analyze the human capital at Nocona Leather Goods and to determine if implementing an outsourcing policy would be beneficial for the company. Additionally, this case provides students with an opportunity to create job descriptions, review compensation practices, and analyze benefits programs while faced with the challenge of competing with countries that offer far less to their employees.

NOCONA'S HISTORY

Nocona Leather Goods Company was established in 1926 in Nocona, Texas by Cad McCalls with a goal of crafting high quality leather accessories and boots. Yet, just a few years later, the company found itself unable to withstand the Depression. As a result, the local bank took ownership of the company. Some of the bankers and a few other local businessmen saw this as an opportunity and decided to invest in the company. During the first year of ownership, the partners nearly lost everything. They experienced a fire and the building nearly burned to the ground. Also, sales fell quickly because consumers were not spending money on leather accessories.

Even with the new ownership, and a new direction, the company continued to face difficult times. McLeod (2002) reported the situation this way: "They were looking for anything to make that would sell during the Depression." In 1934, Nocona Leather Goods Company made its first baseball glove. Nocona was desperate to succeed; if this venture did not, it was possible they would have to close their doors for good. Therefore, they recruited the help of Doc Hughes, a well-known sales representative in the sporting goods industry.

It was about this time that Bob Storey arrived in Nocona, Texas. Earlier in his life, Bob played baseball at Rice University, but came to Nocona, Texas to work for an oil company in hopes of securing his future. Within a short time, he was dating the daughter of a local banker who had invested in Nocona Leather Goods. After a brief engagement, the two were married. In order to ensure that his daughter and new son-in-law maintained residency in Nocona, Texas, the banker offered Bob a position at Nocona Leather Goods. Bob accepted the offer and progressed rapidly in the company as a result of his hard work and dedication.

During WWII, Nocona Leather Goods sold baseball gloves to the U.S. Government for military forces serving in the war. Their contract was for a quarter of a million dollars and they produced 250,000 gloves per year. During that same time period, children perceived Nokona (brand name) gloves as being able to heighten their athletic abilities. For example, future major leaguer Nolan Ryan can be seen in his Alvin, Texas Little League uniform sporting a Nokona glove. As a professional baseball player, Ryan reflected on his choice of Nokona gloves and stated, "You knew you had arrived, when you were able to get a Nokona glove…they asked me if I wanted the more modern kind of glove and I had seen some older pictures of ballplayers, so I chose the older style" (Factory Tours USA, 2008).

Nocona Leather Goods incorporated in 1962 as Nocona Athletic Goods and was run by Bob Storey, who happens to be the father of Rob Storey, the current company president. The Sixties were challenging times for Nocona and other manufacturing companies. In response to the times, many American businesses moved their manufacturing operations overseas to reduce operating costs. Companies that moved overseas were able to significantly reduce their product prices and retail stores stocked their shelves with the cheaper gloves. Storey said his grandfather considered moving their operations overseas but resisted the attraction.

Nonetheless, rather than choosing to outsource, Nocona chose to compete by cutting marketing expenses and putting money into "making a high-quality glove…. We trusted that our loyal dealers and customers would stick with us. Many of them did" (Factory Tours USA, 2008). Over time, professional baseball player endorsements began to escalate out of control and Nocona could not compete so they began catering to softball players. Nocona could not have timed their shift towards softball any better because their decision coincided with the enactment of Title IX by Gerald Ford in 1975. Title IX required schools that received federal funding to offer the same sports opportunities to women as they did to men. Colleges and Universities who offered athletic scholarships to male athletes were now responsible for offering the same number of scholarships to female athletes, which led to a very positive impact on Nocona's sale of softball equipment and supplies. Thus, Title IX aided the sales and growth of the softball glove for Nocona as schools hurried to buy equipment for their female softball teams.

LABOR

The manufacturing of baseball gloves is a basic five step assembly of various pieces made up of a die cutting the glove parts, sewing the shell and lining, inserting the pad (in the heel) and reinforcements (in the thumb and 'little finger'), interlacing the web, stitching and final lacing (around the entire glove). It is routinely done by humans (versus machines), and is, in fact, accomplished faster by hand.

Nocona offers their skilled labor force a piecework compensation package that is based on the number of gloves that a worker makes. On average, the majority of Nocona employees earn \$12.00 to \$14.00 per hour. Storey believes the compensation package that Nocona offers competes well with the company's local employment competition, the hospital, and school district. Many employees of Nocona are the “second bread winner” in their family and, oftentimes, work at Nocona mainly for the affordable medical benefits offered. Nocona pays for eighty-five percent of the employees’ cost of medical coverage, making the employee portion a reasonable cost, so anyone can take advantage of the benefit. Storey states that other than finding skilled labor, providing health benefits at a reasonable cost to employees has been the biggest challenge he faces. This is not unlike the experience of most American employers whose benefit packages tend to approximate 40% of payroll (Bates, 2003)

In addition to offering a competitive financial package, Nocona retains employees by offering flexible work arrangements. For example, many of the employees who have children bring their children to work with them in the morning; the children load the school bus in front of Nocona. When school is out, the children return to Nocona and wait for their parent to get off work. While the children wait, they walk freely through the factory to say hello to their parent and work on homework in the commons area. Though Nocona does not regard itself as having an employee retention program, offering employees the opportunity to bring their children to work offers significant value by way of the reducing the financial burden of childcare expenses.

Nocona’s employees are predominately Hispanic women who are second- and third-generation employees. Many new employees do not have all of the skills required to contribute effectively when they are hired. Therefore, Nocona has implemented training programs for its employees. Some of the training programs are more rigorous than others because of the task being performed. For example, stitchers -- employees who sew the glove together -- complete a fifty-week hands-on training program. In some instances, employees have mastered the craft so well that they are more efficient than the programmable machines, and those are the employees that Storey particularly wants to retain.

INTERNATIONAL LABOR MARKET

The 1980’s saw many Asian governments develop incentives for international corporations to utilize their low-cost manufacturing facilities. As a result, many U.S. firms developed strategic relationships with multiple manufacturers throughout Asia. For example, Reebok began using manufacturers in China, Indonesia, the Philippines, South Korea, Taiwan, and Thailand (Reebok 1989 annual report). Outsourcing entices governments to compete, as they hope to build relationships with large corporations that utilize their readily-available, low-wage workers. A great example of this high-stakes, multi-billion dollar corporate redistribution is Nike Athletics.

Nike originally used small manufacturing facilities in Maine and New Hampshire and began outsourcing most of their manufacturing operations to Japan in 1972. As the Japanese labor market became more competitive, wages rose, causing other countries’ labor pools to become economically preferable. By the 1980’s, Nike moved its outsourced manufacturing to South Korea and Taiwan. Again, these countries developed progressively as more money flowed into the country from global corporations, causing their labor supply to become more expensive. Thus, China, Indonesia, and Vietnam entered the “low wage” competition. Today, Nike has their products outsourced to manufacturers in 51 countries (Nike, Corporate Responsibility Report, FY 2001). Table 1 illustrates labor cost differences among a variety of countries.

Table 1

	Hourly Labor Costs Textile (US $)†	Annual Labor Cost Per Worker*	Adjusted Labor Cost for Glove Making**	Adjusted Annual Labor Cost*
Bangladesh	0.31	644.80	0.23	481.47
Vietnam	0.57	1,185.60	0.43	885.28
Indonesia	0.83	1,726.40	0.62	1,289.09
India	0.85	1,768.00	0.63	1,320.15
China	1.44	2,995.20	1.08	2,236.49
Malaysia	1.57	3,265.60	1.17	2,438.39
Thailand	1.8	3,744.00	1.34	2,795.61
Mexico	2.17	4,513.60	1.62	3,370.26
South Korea	6.31	13,124.80	4.71	9,800.16
Taiwan	7.89	16,411.20	5.89	12,254.08
US	**17.41**	**36,212.80**	**13.00**	**27,039.74**
Japan	30.81	64,084.80	23.01	47,851.48

* Based on 40 hour work week, 52 weeks per year.
** Based on Nocona's hourly average of $13, or 74.7% of textile labor costs.
†Source: Werner International. Textile Labor Cost Comparisons, 2008 (2009).

It is also important to note that governments aggressively try to persuade companies to move contracts to their respective country. In turn, the corporations give incentives to manufacturers to transfer their operations to a specific country. These incentives are in the form of guaranteed contracts.

PRODUCT

One of Nocona's competitive advantages is offering gloves that utilize hides other than cattle. For example, they offer Kangaroo hide which is softer than the traditional cattle hide and has a shorter "break-in" period which allows the glove to be used sooner. Similarly, Nocona does all of their manufacturing by hand, insisting that machines cannot compete with the quality of experienced hands. The quality of craftsmanship is noticeable in the marketplace as well.

The baseball website 'Rampage Baseball - All Baseball All the Time' notes "Nocona truly leads the pack in baseball glove flexibility, quality, and craftsmanship" (Baseball Rampage, 2009, ¶ 2). However, the quality of craftsmanship does have its price as Nocona is forced to forward their respectively higher labor costs onto customers in the form of higher prices. While their competitors' gloves normally sell in the U.S. from $29 to $79, with only a small percentage exceeding $100, Nocona's pricing begins at $150 and many of their gloves exceed $200 at the retail level. Furthermore, Nocona does not use endorsements from professional athletes, a strategy that virtually all of their competitors employ. There is no doubt that Nocona loses many potential customers due to their higher priced gloves and lack of big name endorsements.

TWENTY-FIRST CENTURY NOCONA

In the early morning on July 18, 2006, Nocona encountered its second fire that was most likely started by an electrical short. The fire moved swiftly through the factory, fueled by the materials inside.

Storey acted quickly in establishing a plan of action. He assured employees the company would continue and that they could expect to receive their regular pay during the rebuilding period. Nocona simply could not afford to lose their employees to local competition; neither could they train new employees quickly enough to be efficient when employees could return to work after the fire. Many of employees had been with the company so long that management knew they would not be able to immediately find the equivalent skill level and knowledge their current employees possessed. Furthermore, Storey felt that continuing to pay Nocona's employees was the moral thing to do and was of significant importance to the company's future.

While the facility was being rebuild, employees would meet in the morning at the remnants of the old building and go through the debris in search of salvageable equipment while other employees searched the Internet and contacted vendors in search of equipment the company utilized to manufacture the gloves. With the diligent work of all Nocona employees, it was inevitable the company would be operating again in no time.

Nocona relied on their insurance settlement to pay for employees' wages, the expense of relocating, and replacing some of the equipment lost in the fire. The remaining settlement money was added to the funds the company had recently started spending on marketing - an area of business Nocona had neglected for many years.

Within two months, Storey had secured a new location with the assistance of The Nocona Economic Development Commission. Nocona Athletics Goods is expected to purchase the building in 2009. There are plans to renovate the building and Storey wants to devote space in the renovated facility to display Nocona's involvement in America's favorite past time and provide a facility that is welcoming to employees and families.

Shortly before the fire, Storey, along with 10 family members who sit on Nocona's board, made the decision to sell 50 percent of the company to a group of investors from Boston. They believed the sale was necessary if Nocona was going to be positioned well in the market. With new investors, Nocona would have the financial support and resources required to advance their company. Shortly after the sale, Nocona began an extensive marketing campaign. The investors also assisted Nocona in obtaining a joint venture with a Massachusetts glove company. The joint venture has tapped into an array of skilled laborers and the opportunity to place employees from both locations on the same healthcare plan. Storey anticipates that with the revised healthcare plan he will be able to offer his employees a better plan with lower insurance premiums as a result of obtaining economies of scale.

More recently, Buddy Lewis, one of the new investors, has contributed significantly to Nocona by building a bat factory in Fall River, Massachusetts. Buddy Lewis wanted to ensure in that the design of the facility created a "tourist attraction with an on-site amphitheatre for hitting clinics and a baseball diamond. It will be neat" (Grillo, 2007, ¶ 4).

Though Nocona is moving forward, Storey finds giving up full control to be difficult. He considers some of the poor choices that have ultimately led to the sale of part of the company. If he were able to rewind decisions that were fatal to the company to retain full ownership, he would. Some of the decisions he considers fatal to Nocona include keeping all of the production in the United States when everyone else had moved overseas and maintaining operations in Nocona, Texas instead of moving to a more populated area. Storey's mind is filled with arguments for outsourcing as well as against it. Moreover, he knows that this is a major decision that could lead his company through the 21st century, or remove it entirely. He questions what he should do.

INSTRUCTOR'S GUIDE

There are two options for this case, both of which have been successfully used in graduate and undergraduate programs. Version 1 is to be used "in class" whereas Version 2 can be used as an ongoing project throughout the semester. Also, there is a Supplemental Guide that can be used by the instructor with either Version 1 or 2. Regardless of whether or not the Supplemental Guide if formally used, it is <u>strongly recommended</u> that the professor read it in full. Doing so will greatly enhance insight to the outsourcing issues of this case. Of course, the instructor can easily make the Supplemental Guide a formal portion of the case study for a more robust analysis.

Version 1

Case Objective Overview Analysis

The impetus for this case is simply one of survival for the lone remaining baseball glove company in America. Whereas other makers have sent manufacturing overseas, Nocona Glove Company has proudly remained as the only company to state "Made in the U.S.A." on their products. However, this is also their greatest challenge. While Nocona pays $12 to $14 an hour along with 85% of the cost of health insurance, their competitors pay foreign labor wages that begin at 31¢ per hour, with no health insurance benefits. Thus, while Nocona Gloves are indeed "Made in the U.S.A" they sell for $149 whereas comparable foreign-made gloves can be purchased for $29.

Courses and Levels

This case is recommended for college students at or above the junior level, including master candidates. It could be used in a capstone management course or strategic HR management.

Discussion Questions

What should Nocona consider in terms of finding competitive solutions for:

- Manufacturing
- Employees
  - Benefits
  - "Second Bread Winners"
- Marketing
  - *Remember:* "Made in the USA" is a human capital (HR) issue.
- Geographic Location (unionized areas, pro-employee worker's compensation states, unemployment rates, pay rates)
- Product Diversification

Do you agree with the company's recent choices and decisions?

Version 1 will likely require the need of computer access. Thus, consider asking students to bring their laptops or perhaps make this a take home assignment. Although Version 1 can be done individually, it is recommended that you use groups.

Prior use of this case has revealed very different perspectives of how Nocona should go forward, yet all of the choices have pitfalls that are easily identified. If time permits, have the groups present their decisions and have other groups pose those challenges/pitfalls. On the other hand, occasionally a group will find a comparable dilemma at companies such as Fender Guitar Company and will extrapolate some very insightful alternatives.

Version 2

This version is for junior and senior level undergraduate students enrolled in an HR Management or Compensation course and involves four key steps that coincide with most compensation textbooks. It is normally done in groups of four as a semester long project. Also, this version assumes that the company has decided to continue manufacturing in America but needs to build a new manufacturing plant. Please note that although the dilemma in the case description is whether or not to manufacture overseas, the pressures of off-shoring will still exist even if Nocona keeps manufacturing in America. Thus, the following decisions are crucial to Nocona's survival. Version 2 has been successfully used alongside <u>Compensation</u> by Milkovich & Newman (2008).

A valuable connection between the case study and Version 2 is that, although students are likely to use the Internet for research, they will not find job descriptions for glove makers or information on managing a glove manufacturing plant. Likewise, they will find very little information on baseball glove companies. Although they will likely read about Nocona, the students are forced to extrapolate due to the very limited amount of information about glove making.

<u>Step 1:</u>

The goal of this portion of the project is twofold.

1) Create job descriptions for the following:

a. Baseball glove makers (approximately 50 employees): Basic duties include cutting, curing, and sewing baseball gloves.
b. Director of Production: Basic duties include purchasing, scheduling, safety, managing the shop.
c. Office Manager: Basic duties include HR, bookkeeping, community relations.
d. Shipping Manager: Basic duties include managing inventory and shipping the gloves to various retail warehouses using private couriers.

For each of the above four positions, write detailed job descriptions for someone who would hold the position at a baseball factory. It is important to expand the basic duties into realistic job descriptions that portray what someone in the mentioned position would actually do and encounter (physical, ADA, safety, etc.) as well as the required KSA's.

2) Determine in which city to locate your baseball glove factory. Here is a starting point of things your group can review and/or consider:

a. Unemployment rates
b. Cost of living
c. Average education
d. Available workforce
e. Average pay rate
f. Other "employment" reasons your choice is the best city

Provide the name of the city you chose and review the comprehensive analysis used to determine your selected city. You are welcome to integrate management analysis techniques that you have learned in other courses.

<u>Step 2</u>

Assume that the company president or CEO is favorably considering building a facility in the area that you identified during Step 1. However, the CFO needs to develop a rough estimate of potential labor costs. To conduct this analysis, the CFO first needs to know, in terms of base pay, how much will each of the following be paid? (This is the underlying question of the assignment.)

a. Glove Makers
b. Director of Production
c. Office Manager
d. Shipping Manager

Thus, there are three primary components to this portion of the project.

A) Conduct a Wage Survey. This survey should include the following:
   1. Selecting Relevant Market Competitors
      a. Occupation
      b. Geographic

c. Similar Products

2. Designing the Survey
    a. Who Should Be Involved
    b. How Many Employers

B) Gather the following data.
1. Public Data
2. Internet Data
3. Contacting the Competition

C) Interpret the Data
1. Verification
2. Statistical Analysis
3. Construct a Market Pay Line

Provide a straightforward answer in terms of base pay, followed by an adequate explanation of how you determined the salary for each position.

Step 3

This portion of the project has three major components as listed below:

1. Create a Job Evaluation System: Include a written description of how each of the following positions will be evaluated. Although one Likert-style evaluation sheet could be used for all employees, it is unlikely to be the best way to evaluate the employees/occupations. Rather, some employees might be measured simply on output, whereas others might be measured on key factors that are much harder to quantify. Explain your decision for each evaluation method, and how you will accomplish this for each position.

    a. Glove Makers
    b. Director of Production
    c. Office Manager
    d. Shipping Manager

2. **Create Pay for Performance Systems**: Include a thorough description of how the employees' performance will impact their pay. Use key terms and methods from the text and outside sources as needed. Also, include potential pitfalls; that is, how might employees abuse your design. Remember, the Pay for Performance System should be commensurate with the job descriptions that you created earlier in this case.

    a. Glove Makers
    b. Director of Production
    c. Office Manager
    d. Shipping Manager

3. **Select a Health Insurance Plan**: Acquire three health insurance plans and decide which plan to offer to your employees and explain (analyze) why it is the best choice. This should include the monthly amount billed to the employer (per enrollment and overall), the portion(s) the employee pays per tier: single, couple, children, family, etc. Tip: contact the HR Manager at your employer or a family member's employer for plans and costs. Most companies should be willing to share this. Include a copy of the plan with your report. The demographics at that employer might be different than the baseball glove company, which is not a problem for this assignment.

SUPPLEMENTAL GUIDE FOR OUTSOUCING

If you have students that plan to utilize outsourcing as their preferred option, make sure that they analyze costs, as well as benefits, and explain each in their proposal.

Potential Costs of Outsourcing

The potential increases in costs associated with outsourcing include the following (percent of total product cost in parentheses):

A. Vendor Selection (5%)

Travelling to Asia is a wearing experience for executives. It takes the better part of a day, so U.S. companies typically have executives stay for lengthy periods of time, from a week to ten days. It usually takes a minimum of three trips to engage a vendor and develop an initial working relationship. Because of the nature of the position and the exhausting nature of the travel, most companies utilize business-class travel, which adds to the overall cost. It cannot be overemphasized that maintaining the business relationship requires frequent in-person contact. Also included in these selection costs are documenting the requirements, sending out requests for proposals (RFP's), evaluating the responses, and negotiating a contract. This entire amount can range from 1%-10%. For this case, 5% is a conservative amount.

B. Training and Loss of Control (8%)

Since Nocona's entire reputation is based on quality, the manufacturing quality is a matter that requires constant attention. Low cost labor exists, by definition, because there is an ample supply of untrained workers trying to make a higher quality existence for themselves and their families. Since compensation is usually based on how many gloves are completed, any glove completed is a "good." In the past, firms that have utilized outsourcing are astounded when a shipping crate is opened only to discover a cadre of quality flaws. Thus, another cost gets added in the form of inspection before shipment. Historically, quality defects are between 1 and 8% of product cost, but since this is such a crucial area for Nocona, that figure could easily be doubled. Thus, we assume a quality cost of 10%. Please note that this could be the deal breaker for this firm. If word 'gets out' that quality is now subpar, AND that the gloves are no longer "Made in the USA," it could be disastrous for the firm.

C. Production & Lag Issues (20%)

This is one of the critical areas that hurts the concept of outsourcing. It is paramount to remember that replacing one worker with another is not like switching parts on a car. The labor intensive aspect of this manufacturing process includes many potential areas of disaster. One area that Nocona currently utilizes is having workers speak up and offer suggestions for improvement. The higher power-distance characteristic of some Asian cultures virtually eliminates this benefit. These outsource vendors are also well known for high turnover. The National Association of Software and Service Companies states that Asian attrition rates are common, as high as 35% in India. Turnover can cost an additional 5 % to 7%. Finally, it is important to acknowledge the language barrier. Differing languages slow processes and add costs around 2 % to 5 %. Time lag issues can range anywhere from 9% to 27%. For this case, we feel that 20% is on the mark.

D. Managing an Offshore Contract (8%)

Managing the actual offshore relationship is also a major additional cost. There is a significant amount of work in invoicing, auditing, ensuring cost centers are charged correctly, and making sure time is properly recorded. Project managers are utilized to oversee this aspect. The project manager works with the vendor to audit the time sheets, and create an invoice. The project manager must then audit the invoice against the overall project, which is then sent to accounts payable for disbursement. A usual cost range is 6%-10%.

E. The Cost of Transition (6 %)

There are several areas that add significant costs in transition. Managing the transition of the project and third-party consultant oversight (if outside verification and validation is needed) are profit drainers. Managing communications is key. There is no doubt that a public relations firm will be necessary to avoid a public relations nightmare if and when word gets out that America's last glove manufacturer has left America. Obviously, professional firms would need to be retained to develop and implement advertising campaigns aimed to retain current clients, as well as facilitate future buyers. Legal fees for the establishment and interpretation of new vendor contracts are also expensive.

F. Layoffs (4 %)

Laying off workers is not without cost. In the U.S., most firms offer workers retention bonuses or severance packages. If your workers know that their job will eventually be outsourced, you need to provide them with an incentive to stay with the firm until your new manufacturing operations begin abroad. Paying incentives might not be enough to offset worker dissatisfaction and slowdowns. Local governments could join workers in legal action, which only adds to the costs of outsourcing.

G. Shipping (6% of product cost)

A consolidated sea freight estimate is $.75/pound (Michelini, 2003). From Asia, shipping times can fluctuate from 6 to 8 weeks. Also, cargo must be insured for loss and breakage in the form of inventory carrying costs. As an example, a cargo container carrying gloves worth $100/unit would experience a carrying cost of 30% per year, equaling 4% of product costs or $9,100. Another expense is duty and shipping fees, approximating $2600 in this case. This does not include transportation from the manufacturing plant to port or from the U.S. port to distributors in the U.S. This amount is usually double the container cost.

H. Endorsements/Marketing (50%)

In 2005, the endorsement arena for free agent athletes in Major League Baseball was $1.09 billion (Harrow, 2005) and is expected to increase further. Likewise, consider that Nike spent $1.6 billion on long term endorsements as of 2003 (Mullen, 2004). This is a high stakes game where money talks. If firms want the top athletes to endorse their product, they must pay, and pay significantly. Currently, the highest paid MLB player, Alex Rodriguez, earned an additional $1.5 million in endorsements in 2009 (along with $32 million in salary). Alex's teammate, Derek Jeter, earned $4 million in endorsements (with $20 million in salary) (Baseball Ten Richest Players, 2009). Most contracts are proprietary, so exact figures are difficult to obtain. We estimate that it would cost millions to compete with other firms to obtain endorsement rights for coveted players. As their major competitor, Reebok is the sponsor of Major League Baseball, it seems very unlikely that Nocona could compete financially with an international sports giant. We would estimate a percentage for Nocona to most likely be 40%-50%.

Note: The percentages listed in items A through H stem from: OSF Global (2009), Szatvanyi (2009), Dewhust & Meeker (2009)

There are numerous other variables that could potentially be involved in an outsourcing decision. Students may suggest:

- Exchange rates/currency fluctuations
- Cost of endorsements (as Nocona now must abandon their current marketing)
- Decreases in brand management (Every client interaction reflects on the company)
- Buildings: Estimated ability to sell 'current manufacturing locations' less the cost of building/renting new locations

However, it is quite difficult to establish values for these items. Moreover, we feel that it starts to fall outside the main points of the case.

<u>Potential Benefits of Outsourcing</u>

A. Decreased Labor Costs (range from 98% to 67% savings*)

Depending on the country utilized, salaries would range from an adjusted low of $.23 in Bangladesh (a 98% savings) to $5.89 in Taiwan (a 67% savings). Obviously, this is the main driver of outsourcing.

* Note: These savings include the absence of benefits which is 40% of payroll.

The key is to determine what percentage of Cost of Goods Sold (COGS) is derived from labor. While specific numbers are not available from Nocona, the National Academic Press states that a 'typical domestic' manufacturer has labor account for 9% of COGS and Load (overhead salaries, benefits, taxes, etc) accounts for another 14% (*Dispelling the manufacturing myth, 1992)*. In our specific case, labor is much more of the process, so we assume that the cost of labor to be at most 35% of COGS.

B. Other Benefits

Outsourcing also converts fixed costs into variable costs, releases capital for investment elsewhere in the business, and affords the company greater flexibility in operations.

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