A Guide To Contract Manufacturing

When it comes to manufacturing, not every company has the resources, capacity or time to do it all cost effectively. Just as many businesses choose to outsource accounting or IT management, so do many companies outsource their manufacturing needs to a firm who can provide a more efficient production run, a faster turnaround, improved quality, and better scalability, among a host of other things.

This is called **contract manufacturing**.

In this comprehensive guide, you’ll learn everything you need to know about how contract manufacturing works, from what the different types are and why you should use it, to how much it costs, what to look out for when choosing a contract manufacturer, and what the risks are.
What Is Contract Manufacturing?

Contract manufacturing is a solution for companies that don’t have a full-service manufacturing and development team. With contract manufacturing, a company outsources its manufacturing process to another manufacturer that is better equipped to handle it.

As indicated by the ‘contract’ part, this process is a formal agreement between two manufacturers that says X will use Y’s manufacturing process to complete their product. In the chemical industry, this is usually a bespoke formulation or preexisting chemical formula. But there are many products that can be outsourced to contract manufacturers, such as essential machine components or electronic parts.

Although contract manufacturing is often used interchangeably with ‘outsourcing’ and ‘subcontracting,’ it’s actually a very different process. Outsourcing and subcontracting encompass both services and physical goods that companies or individuals can provide. This usually includes office-related tasks, like accounting, marketing, IT management or courier services.

Contract manufacturing, as the name suggests, focuses on the manufacturing, packaging, and distribution needs of the client.

How Does Contract Manufacturing Work?

Companies that offer contract manufacturing services are usually able to undertake every stage, or at least some of the stages, of the manufacturing process, from sourcing raw materials and prototyping samples to scaling up production, packaging everything, and delivery. This takes all of the weight off of the client’s shoulders, affording them more time to focus on other areas of their business.

There are six main steps to getting started in a contract manufacturing agreement:

1. Before anything begins, both parties enter a confidentiality agreement to protect the interests of the client.
2. A technical consultation then takes place, wherein the contractor evaluates the technical feasibility of manufacturing the product.
3. Once all the creases have been smoothed out, both the manufacturer and the client company enter into a contract manufacturing agreement.
4. There is then a technology transfer between the two parties, where the client licenses the manufacturer to use any utility models, trademarks, patents, and so on.
5. The next step is testing and validation to ensure that the product can be successfully manufactured to the right specifications. This stage also identifies any problems early on.
6. The final step is the commencement of the manufacturing process, where production is scaled up, packaged, and distributed.
That was a brief overview at the process, and now here's a closer look at the ins and outs of how contract manufacturing works:

- **Components and products**: A client company may either contract all their manufacturing needs to one firm, or they may contract specific components to different contract manufacturers. It doesn’t have to be the whole product; several manufacturers can be contracted for different components. For example, Apple uses several contract manufacturers for the various electronic components of the iPhone. The company itself only assembles the parts that are cheaper to produce and more easily managed.

- **Collaborative work**: In addition to outsourcing production to a manufacturing firm, client companies may also collaborate with the manufacturers to create a new product. This is especially pertinent if a client lacks the technical expertise to develop, for example, a bespoke chemical formulation that ticks all their boxes. With a contract manufacturer, new products can be prototyped and continually refined until they meet the client’s exact requirements. Production is then scaled up. The contract manufacturer is not typically credited in the final product; the client company retains all Intellectual Property rights.

- **Design and quality control**: While it is the client company’s responsibility to provide design specifications and feedback on the product being manufactured, the quality control of the product is the responsibility of the contract manufacturer, who should implement its own quality management system and quality control checks. This is necessary to ensure that the products are compliant with the specifications of the client company. The client company has the right to reject products that are not compliant with the standards they have established.

- **Ongoing or long-term contract**: In many cases, contract manufacturing is an ongoing or long-term agreement, with partnerships that last for many years. For the hiring company, this yields long-term benefits because the contract manufacturer will gain a deep understanding of the product and requirements. This facilitates a harmonious, streamlined manufacturing process and allows the two partners to build an excellent rapport.

- **Non-disclosure agreements**: While it may sound off-putting to share your formula or coveted manufacturing process with another business, there’s no need to worry; contract manufacturing agreements are usually bound by NDAs that protect the client’s ideas, processes, and products.
What Are The Different Types Of Contract Manufacturing?

While it may sound niche in itself, there is actually a variety of different types of contract manufacturing, all tailored to different industries. These range from complex assembly, which typically involves producing mechanical parts for industries like aerospace or fabrication plants, to die casting, which involves forcing a liquid metal into a mold to create complex components.

The type of contract manufacturing you choose can be classified based on the type of goods being produced and whether they’re whole products or component parts.

- **Complete goods owned by a well-known company or brand**: A lot of large-scale and well-known companies contract smaller manufacturing firms to produce their branded goods. Big businesses like Apple, Amazon, and Microsoft typically hire these types of contract manufacturing firms, like the Taiwanese company Foxconn Technology Group, to manufacture products like the iPhone or XBox.

- **Parts or components of a product**: The manufacturing process of complex products requires multiple stages and various specialised machineries. It’s often more cost-effective for hire companies to have various components manufactured by one or more contract manufacturers than to try to manufacture all the parts in-house. This is true for many complex products, ranging from consumer electronics to large commercial airplanes. Some companies simply do not have the necessary machineries and logistics to manufacture all the needed components for their products. For example, simpler components, like customised plastic housings for electronics, require dedicated machinery that an electronics company may not necessarily have. It similarly might be too expensive to maintain specialist equipment just to fabricate components like this. Outsourcing to an expert contract manufacturer with the right equipment is often more cost-effective and results in higher quality products.

- **Labour contract for manufacturing products**: Contract manufacturing can also be used if a hire company doesn’t have sufficient manpower to produce a product, or the budget to hire a large staff of engineers, operators, and skilled workers. This type of contract manufacturing allows such companies to outsource labour to a manufacturing firm that has the capacity to provide affordable labour resources within a particular industry. Workers with highly specialised skills are often costly when hired directly by the client companies. Contract manufacturing solves this issue because the manufacturing firm can use its own trained workforce.

- **Equipment or facility rental**: Buying machinery and the real estate property to store it is costly, especially for start-up and small companies requiring specialist equipment. One viable option is to rent from companies that already have the necessary facilities and equipment. These companies may similarly opt to rent out their resources during periods of downtime. Many small and medium companies choose this arrangement as a cost-effective option. This type of contract manufacturing also provides flexibility and faster ROI compared to purchasing machines and buildings and the time it takes to set everything up.
Within each sector, there will be many different types of contract manufacturing services that you can take advantage of. In the chemical industry alone, this includes things like:

- Bespoke chemical mixing and blending
- Chemical bottling
- Contract packing
- Packaging and label design
- Full production runs
- Management of the supply chain

Contract manufacturing can put you in touch with better equipment and facilities without breaking your budget.

Why Choose Contract Manufacturing?

In a nutshell: it will save you time, money, resources, and a lot of headaches. When it comes to deciding whether you should choose contract manufacturing, there can be a few drawbacks that spring to mind. The cost of outsourcing may at first glance look like a pretty expensive option, and you may also feel uncomfortable with handing the reins over to another business.

But, if you choose the right manufacturer, which we’ll talk more about later on, these concerns will quickly dim by the light of the many advantages that come with contract manufacturing. Indeed, this is usually the best option if a company is looking to save money, reduce labour, and focus on other important aspects of the business.
Why Choose Contract Manufacturing?

1. Reduce costs, save money, maximise profits

Perhaps the most important benefit of contract manufacturing is that it saves you money in many different areas, from the cost of facilities, equipment, and machine maintenance, to operators and product designers. With contract manufacturing, you won't have to spend a large portion of your budget in these areas, allowing you to allocate funds to other important departments in your business. It also eliminates the hassle of periodic machine maintenance, as well as the stress that comes with faulty equipment or costly repairs; the contracted firm will take care of all of this.

Lower labour cost is another advantage. Contract manufacturers hire and manage their own employees, meaning that you’ll receive all the benefits of a large workforce without worrying about hiring a large staff of skilled workers, which can become expensive. Another way in which contract manufacturers can save you money is by using lean manufacturing techniques, which help reduce waste and improve cost savings.

2. Improving resource allocation

Deciding to contract a firm to manufacture your product will give you more time, space, and money to focus on the areas of your business that will help you grow, and where you are the expert.

Similarly, contract manufacturing enables your staff to focus their attention on things like marketing or sales. When you don’t have to worry about the technical details that come with full-scale manufacturing, you’re afforded more opportunity to pursue other important business goals, whether that’s establishing a highly competent sales team or honing in on your marketing efforts.

3. Streamlining your business and its relationships

A major way contract manufacturing services can help streamline your business is by providing reliable quotes and realistic deadlines. This will always put you one step ahead of the curve and prevent you from getting blindsided by unexpected costs, repairs or delays.

Entering into a contract manufacturing agreement will also streamline your business by freeing you from juggling between vendors. With contract manufacturing, the manufacturer typically takes care of things like sourcing raw materials, packing your product, and even distributing it either to you or directly to your customers.

This means that you don’t have to go back and forth between different suppliers, middlemen or distributors. Your operations are simply that much more efficient when you only have to communicate with only one other party. It also facilitates clearer communication by reducing the number of people involved and, in turn, the chances of misunderstandings or errors occurring.

4. Access to technical insight and better equipment

Going into business with a contract manufacturer will ultimately result in a higher quality product. With access to advanced manufacturing tools, like CNC machines, mixing vessels, and precise instruments – or whatever it is that your business requires – the manufacturer will have a greater capacity to ensure that your product meets industry standards.
Similarly, contract manufacturers have the weight of experience behind them: they’ve most likely manufactured a range of different products for many different companies, meaning that they’re able to identify and resolve any problems that could arise. You can also leverage this experience by making use of their technical insight. A good contract manufacturer, for example, will be able to offer advice on how to make your product the best it can be, and this advice will usually be backed up by years or decades of know-how.

5. Faster production and turnaround

With access to the right equipment and technical advice, contract manufacturers can also provide a much faster production time and turnaround than if you were to undertake the process yourself. This is a direct result of high levels of efficiency that manufacturers employ, from their advanced prototyping tools to their network of trusted suppliers and distributors.

Working with vendors, sourcing raw materials, operating machines, and organising couriers all contribute to slower production, so by taking these duties off your hands, contract manufacturers can massively streamline production time and increase efficiency.

Faster production times also directly impact your bottom line – you’ll get a quicker ROI as you’ll be able to fulfil orders more promptly.

6. Better quality control

Manufacturing is a high-stakes industry that requires firms to ensure a minimum level of quality. Beyond this, manufacturing firms need a competitive edge in order to stay ahead of the game, and most find this by earning accreditations to a range of industry standards, like the ISO 9001 quality standard. What this means is that a contract manufacturer usually has a stringent quality management system in place that your product will be manufactured to.

Better quality control means that the firm will be able to comply with the specifications you have outlined. It also significantly reduces the possibility of inferior or faulty products.

7. Scalability

Another advantage of contract manufacturing is better and more affordable scalability. This is because, even when production increases, contract manufacturers are able to keep costs low due to their longstanding relationships with vendors and capacity to procure bulk materials at competitive prices.

By doing this, you’ll be able to scale-up production without having to pay a significant amount more. Additionally, a contract manufacturer’s access to specialist equipment, production facilities, and packaging materials means that they have the capacity to scale up your product to extremely high quantities. In a nutshell, not only will you not have to worry about whether or not you’re physically able to increase production, you also won’t be burdened with the expensive costs of doing so.

8. Responding to uneven market demands

There will always be some peak seasons wherein your production capacity will be overwhelmed. It’s during these seasons that you need to ensure you can meet the demand – and that’s where a contract manufacturer comes in. By helping you meet demands all year round, even during your busiest periods, you’ll be able to outshine many of your competitors by establishing yourself as a trustworthy and reliable business.
Contract manufacturing ensures a steady flow of business, making it possible for you to continue growing without the stresses of downtime or warehouse closures.

9. Better competitive edge

When all of these factors come together, from reduced costs and faster production to better quality control and scalability, they amalgamate into one main advantage: a huge competitive edge.

A company’s competitive edge can significantly improve in terms of efficiency and quality when they enter a contract manufacturing agreement. With better equipment, facilities, and know-how, as well as a faster turnaround, your products will be able to be delivered to a larger consumer base while constantly maintaining a high level of quality.
Examples Of Contract Manufacturing

Contract manufacturing can range from simple, individual components to complete final products. It all depends on what you need and the expertise of the firms you hire. Categories of contract manufacturing include virtually all types of tangible products, such as chemicals, computers, mobile phones, toys, and cosmetics.

Even some of the world’s most well-known brands are engaged in contract manufacturing agreements with other firms. Here are a few famous examples:

1. Xbox

This game console is made by Flextronics Corporation, which has a manufacturing contract with Microsoft, which provides the software and the hardware design specifications. Flextronics are then able to manufacture the products at a more cost-effective and timely rate.

2. Ford Motors

This automotive giant is a pioneer in the automobile manufacturing industry, but it relies on several suppliers and contract manufacturers. Many of the components of Ford cars are manufactured by other companies, such as airbags from Autoliv, axle assemblies from Warn Industries, and door hinges and arms from Flex-N-Gate Seeburn.

3. McDonald’s

This fast food chain has several suppliers and contract manufacturers, including toy making companies for their beloved Happy Meals. Among its main food-related contract manufacturers are Tyson Foods (TSN), Lopez Foods, 100 Circle Farms, Gaviña Gourmet Coffee, and Hildebrandt Farms. Without these suppliers and contract manufacturers, the various franchise outlets of the fast food company wouldn’t be able to operate.

Case Study: ReAgent and Quality Engineered Aerospace Products

To have a better understanding of contract manufacturing, we can briefly examine a specific case study where ReAgent, as a contract manufacturer, worked with a global leader in quality engineered aerospace products:

• The client:

The client is a leading global company that specialises in rolled rings and specialty metal for the aerospace industry. The products of the company are used in various aircrafts, including military aircrafts like helicopters, private jets, and large commercial airplanes.

• This company has customers in more than 40 countries and serves a wide range of markets that include power generation, mining, and quarrying sectors. The client discovered ReAgent online and entered into a contract manufacturing agreement for chemicals.
The objectives:

The client wanted to reduce the costs of manufacturing the chemicals they needed for their products, while also improving the lead time. These chemicals are specialist acid blends that need to be precisely manufactured. The client also wanted to improve the safety for their own employees, who wouldn’t be as well-trained at handling hazardous materials.

The solution:

ReAgent manufactured the required products based on the specific blends. It supplied the client with 1,000-litre intermediate bulk containers (IBCs). ReAgent is now supplying the client with three specialist inorganic blends on a regular basis and provides on-demand chemicals.

How To Find A Contract Manufacturer

Finding the right contract manufacturer for your business involves many considerations. This is a process that should be carefully completed in order to ensure you have the right contractor on board. By following these tips, you’ll avoid disappointment and ensure that the integrity of your product is upheld:

Don’t be too hasty:

First of all, take your time when it comes to choosing. Being too hasty in your search may lead to you hiring the wrong firm for the job, which could incur greater costs down the road. Remember that all manufacturing firms will be eager to secure new clients and work with you, so keep a clear head and make sure that you compare different companies.

Conduct interviews:

Don’t be afraid of getting personal with prospective contract manufacturers. Schedule interviews with the managers of the firms you’re considering and ask probing questions about their capabilities of supplying your company. Doing this will help you gauge whether a firm is the best fit for your business.

Research the market value:

Compare the costs and get to know the fair market value of the services being offered by contractors. However, don’t just choose the cheapest manufacturer, because this could compromise the quality of your products. Just ensure that the services you’re being offered are fair for what you’ll be receiving.

Understand the company’s capabilities:

Not all companies in the same industry have the same capabilities or levels of expertise. You must ensure that the company you hire can deliver on what they promise. To do this, you can check the specifications of their machines as well as the production capacity of their facilities. Undertaking an audit is a great way of understanding whether a contract manufacturer can fulfil your requirements.
• Do background checks on the experience level:

Experience in the industry is an important consideration because without it, it can be difficult for a manufacturing firm to overcome specific obstacles or provide industry-specific solutions. Indeed, there are several challenges that can only be solved by highly experienced companies.

• Competency evaluation for staff:

Productivity and quality ultimately boil down to staff competencies. You must check whether the workers are qualified and have the proper training and skills. Ask the prospective manufacturer for this information. You should also visit their site, meet members of the team who might be working on your product, and see their production in action.

• Compare cost savings:

One of the primary goals of entering into a contract manufacturing agreement is to reduce costs. When selecting a firm, make sure you’re choosing the most cost-effective offer, not just the one that costs the least up-front. By keeping future cost savings in mind, you’ll be able to choose a contract manufacturer that saves you money in the long-term, not just in the present.

Always conduct interviews with your prospective contract manufacturers so that you can ask important questions and assess whether they can meet your needs.
What Makes A Good Contract Manufacturer?

A good contract manufacturer complies with all the applicable standards and is capable of delivering their promised services. A good way to screen a company is to find out whether it is ISO compliant. If it complies with any or several of these standards, it means that it has undergone stringent quality inspections and passed the international standards for its industry. The other factors that you should consider are the following:

- **Hygiene and cleanliness:**

  This is crucial not only for food-related products and medicines but also for other products in general. Contamination can ruin a product's quality and, in turn, damage your reputation. This is especially important if the products being manufactured are sensitive, such as electronic circuits, which need to be made in an environment free from dust and other contaminants.

- **Competent management of the facility:**

  Even if a facility boasts all the necessary equipment and specialist machineries, they will only run as well as the people who operate them. The managers and staff must be highly qualified and well-trained to operate the equipment.

- **Level of advancement in terms of equipment and technology:**

  Choosing a company that has state-of-the art technology often makes for more efficient and cost-effective production, saving you money in the long term.

- **Capacity to deliver on their promise:**

  Make sure that the company can actually deliver the products that you need on time. A good way to gauge if a manufacturer can do this is to check out past client testimonials and reviews.

- **Internal quality control standards:**

  The internal standards of a manufacturing firm should be at least on par with the international standards, if not superior. Ensure that they use a quality management system and have all the necessary steps in place to produce a high-quality product.

What Should You Ask a Contract Manufacturing Company?

During your interview with a prospective contract manufacturer, you should ask some pertinent and probing questions. These will help you assess the capabilities and trustworthiness of the company. Here are some questions you could ask:
How can you ensure that the Intellectual Property rights of our company will be protected?

How transparent is your company in terms of the financial aspects?

Who will be the main liaison officer or direct contact of your company whenever we have concerns that should be immediately addressed? (Make sure you meet this person!)

Do you have specific policies and processes that will ensure efficiency and productivity on-site?

Can you give me the assurance that your production will be consistent with my specifications and quality standards?

How Much Does Contract Manufacturing Cost?

As a rule of thumb, contract manufacturing costs should not exceed the cost of production. But it’s important to bear in mind that cost isn’t the only consideration. Oftentimes, companies enter into contract manufacturing agreements because they themselves do not have the technical or logistical capacity to produce the product.

Therefore, the cost could fluctuate depending on what the contracting parties agree upon. In general, the cost should be competitive and based on the prevailing fair market value. Of course, the contract manufacturing company also has to make a profit. The basic formula you can use to get a ballpark idea of the cost of contract manufacturing is to add the production cost and the profit margin together.

You should also keep various factors in mind when figuring out the contract cost, including:

- Labour cost
- Cost of materials
- Overhead costs, like electricity bills
- Machine maintenance costs
- Profit margin or markup per product unit

Typically, overheads, labour, material, and maintenance costs are non-negotiable.
What Are The Risks Of Contract Manufacturing?

Both the contract manufacturing company and the client company must consider the risks and disadvantages involved in entering into an agreement. While you can manage most of the risks, some are not in your control, whether you’re the contractor or the client.

- **Very limited or no control:**

  If you’re the contractor, you don’t have a strong leverage in terms of product design. You should always follow the specifications and standards of the client. If you don’t, the contract might be abrogated. While you can suggest some improvements, the client has the final decision.

- **Risk of hiring the wrong contractor:**

  If you’re the client, you might end up hiring the wrong contractor if you don’t carry out proper vetting. The quality of your products and your reputation may suffer as a result. Depending on the stipulations of the contract, you could also lose large sums of capital investment. This is why it’s important to be as thorough as you can during the hiring process.

- **Prioritisation issues:**

  The timely delivery of your products is crucial. However, it’s unlikely that your company is the only client of the contract manufacturing firm. This means that you would be competing with other clients for attention to your product.

- **Job displacements:**

  Some of your employees might lose their jobs if you enter into a contract manufacturing agreement. This is because job positions, like operators, engineers or production workers, could become obsolete.

- **Wasted resources:**

  Some of your assets, like machineries and supply warehouses, might also become unnecessary burdens as you’ll no longer have need for them. Maintaining equipment like this without using it results in a lot of unnecessary costs, so consider selling any unused assets once you’re confident that your contract manufacturer can handle your needs.

- **Possible labour abuse:**

  If you outsource your manufacturing abroad, some contracting companies might have what we would consider unfair and exploitative labour practices that you are unaware of. You will not have control over this issue. Again, always vet the contract manufacturer you’re considering to ensure that they comply with ethical practices.

That concludes our comprehensive guide on contract manufacturing. We hope that after reading, you feel more informed about the process and better equipped to make the all-important decision of whether to outsource your manufacturing needs. If you would like to discuss your specific requirements any further, feel free to contact our friendly team of experts on 0800 9555 798.