Ohio Art: A Case Study in Global Outsourcing

James A. Pope, College of Business Administration, University of Toledo
jpope@utoledo.edu

Ohio Art was founded in Bryan, Ohio, in 1908. They have specialized since in making of toys for children. [5] In the late 1950's, they acquired the rights to a toy developed in France—the Etch A Sketch. [4] Ohio Art added the toy to its product line in 1960 at a price of US$3.99. Although the mechanism is fairly complex, the Etch A Sketch is easy to use. The user manipulates two knobs which control the x- and y-axis of a line drawn inside the toy on pane of glass covered with an aluminum powder. When the user wishes to start over, he or she simply turns the toy upside down and shakes it to erase the lines and start with a clean slate. Etch A Sketch quickly became an almost iconic toy, not only among children, but also with a niche of artists specializing in Etch A Sketch drawings. The Ohio Art web site, for example, shows portraits of their top management drawn on Etch A Sketches.[5] It was even the subject of the most popular Dilbert cartoon ever (3 April 1995). [2]

In the 1980s and 1990s, stores such as WalMart, Toys-R-Us and Target became the main retailers of toys. Their objectives were to be low cost sellers of children's toys. As a result, Ohio Art was under increasing pressure to keep down their costs and prices. The expectation was that the Etch A Sketch toy would sell for under US$10, less than half of its inflation adjusted price when it was introduced (US$23.69). [6] In the late 1990s, with the burden of U.S. labor costs and corresponding health care benefits, Ohio Art decided to move production of all its toys, including Etch A Sketch, off-shore to China. Although their financial reports do not break out results for individual toys, their 10-K reports show clearly that they were losing money steadily in the 1990s. [1]

They contracted with Kin Ki Industrial in Shenzhen, near Hong Kong. [6,4] Although they gained a labor cost advantage by moving production to China, it came with other costs, most hard to quantify.

There are several dimensions in which operations can work to support the organizational strategy. One, obviously, is cost. Because operations was unable to produce at a low enough cost, the firm chose to move production to China where the delivered cost of Etch A Sketch was 20 to 30 percent less than the cost of making it in Bryan. This was accomplished primarily by paying the workers US$0.24 per hour in China instead of US$9 in Ohio.[6]

Operations lost the ability to work in other dimensions, however. Because the toys are made in China and the bulk of toy sales is during the end-of-year holiday season, Ohio Art must forecast sales far in advance and place their orders months ahead of when they are needed. This means they have virtually no flexibility in changing the volume of production. For example, if a media personality of some type were seen using an Etch A Sketch in the fall months, demand might increase dramatically. If they were producing in Ohio, they could add over-time and shifts to increase production to meet the spike in demand. Likewise, if demand dropped, they could slow down production. With production in China, once an order has been placed, produced and put on a ship, that is what they will receive. They do not have the option of increasing or decreasing their orders.

Another dimension is quality. Although Ohio Art claims to be satisfied with the quality of the work coming from China, they would not catch any quality problems until the toys were delivered to them in Ohio. This could mean thousands of defective toys with no option to replace them in time for the holiday season. If they were made in Bryan, defects would be caught right away and they could take corrective actions.

Another cost that is hard to quantify is the increased risk in the logistics system. The toys are made in China, loaded in containers, and shipped to the U.S. via a major west coast port such as Los Angeles or Long Beach. They are then transshipped by truck or rail to Ohio. A real cost is the cost of carrying the inventory for the shipment time, which can stretch to months. The average time for shipments from China to reach U.S. shores (not their final destinations) is 45 days.[3] A less quantifiable risk is that the containers will not arrive or that they will be damaged enroute. Estimates of the numbers of containers lost at sea each year range from 2000 to 10,000. There are documented cases of containers full of toys, sporting goods and shoes being lost at sea and being washed up around the world. Other hazards are pirates and treacherous sea lanes. At the port, containers can be held up for a variety of reasons from congestion at the port to impoundment by the Customs Service.[7] In their 2004 10-K Report, the company stated that sales had been "…impacted by the West Coast dock strike." [1]

The company fairly quickly discovered a big risk in moving overseas—that of dealing with a vendor who is not completely honest. The New York *Times* did an exposé of Chinese toy manufacturers and featured Ohio Art in an article on 7 December 2003. It seems that the Kin Ki Industrial promised Ohio Art that their workers had work contracts, pensions, medical benefits, good food and comfortable dormitories on top of earning minimum wage or above. It turned out, according to the *Times*, that none of this was true. The workers were working seven days per week with no overtime, living in crowded conditions, being fed a scanty diet, and earning less than the Chinese minimum wage. The CEO of Ohio Art, William C. Killgallon, denied having knowledge of any of this and promised to visit China. The company lost a good deal of good will and suffered a public relations disaster because they failed to monitor their vendor and simply accepted what they were told. [6]

The underlying problem is that many of the costs of global outsourcing are not quantifiable and do not appear in the company accounts. Labor costs obviously do appear in the accounts; but failure to take other costs which may not appear in the accounts into consideration, but which certainly affect the bottom line, can cause the outsourcing 'deal' to succeed or fail. Ohio Art is not alone. A 2008 Pricewaterhouse-Coopers survey of retail and consumer-goods companies revealed that a quarter of the companies could not quantify actual savings from outsourcing abroad. [3]

References

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