



# When Food Manufacturers Must Choose Between In-House and Contract Manufacturing



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## Choosing Between In-House and Contract Manufacturing

Most food producers—at some point in their product's lifecycle—arrive at a fork-in-the-road moment where they must decide to manufacture in-house or outsource production to a contract manufacturer. Whether that moment occurs at the onset of a commercialization opportunity, once demand exceeds in-house capacity or when the economics reach a trigger point, determining the right production strategy can be complicated. Each option has pros and cons that must be understood and considered in harmony with the producer's unique objectives and opportunities.

Certainly, the food industry's use of contractors is growing rapidly. In the U.S., the contract manufacturing and packaging market is projected to grow at a nearly 10% annual rate<sup>1</sup>, more than twice that of the packaged food market itself. It is estimated that approximately two-thirds of food and beverage manufacturers outsource at least a portion of their production<sup>2</sup>.

*But is outsourcing production right for you, or are you better off manufacturing your products in-house? Maybe a combination of both? In this guide, we'll explore the factors that go into making the best decisions for your situation.*

<sup>1</sup> <https://www.mordorintelligence.com/industry-reports/united-states-contract-packaging-market>

<sup>2</sup> [https://www.foodprocessing.com/assets/knowledge\\_centers/grant\\_thornton/assets/survey\\_fastfacts\\_outsourcing\\_2.pdf](https://www.foodprocessing.com/assets/knowledge_centers/grant_thornton/assets/survey_fastfacts_outsourcing_2.pdf)

## The Case for Using a Contract Manufacturer

There are many advantages to outsourcing manufacturing to a third-party contractor. Most obvious is avoiding having to invest in the facility, equipment and staff necessary to produce your product, particularly at commercial scale. Contract manufacturers have the infrastructure and skills to handle it all; from sourcing ingredients to shipping finished product, and everything in between. Concerns over finding, training and managing workers, complying with health and safety regulations, cleaning and maintaining equipment and other day-to-day challenges are the contractor's problem, not yours.

This allows you to focus on the tasks that will grow your business, like sales, marketing and new product development.

Here are the key pros and cons of using a contract manufacturer:

PROS	CONS
<ul style="list-style-type: none"><li>• No capital investment for facility or equipment</li><li>• No need to hire, train or manage staff</li><li>• Ability to scale production to your need</li><li>• Access to wide range of support services</li><li>• Geographic flexibility for production</li></ul>	<ul style="list-style-type: none"><li>• Limited access to verify product quality</li><li>• Potential for your product to be delayed in favor of a higher priority customer</li><li>• Capabilities limited to the equipment available</li><li>• Potential for competitive products to be manufactured at the same contractor</li><li>• Risk of depending on the stability of a third-party business</li></ul>

## The Case for Manufacturing In-House

On the other hand, in-house manufacturing has its own advantages. Primary among them are issues around control. You can monitor and maintain much better control over product quality by manufacturing your own product, ensuring that each batch is up to your standards. Production scheduling will also be under your control, so there is no chance that your urgent need for product by next week will get bumped from the contract manufacturer's production schedule in favor of a bigger, more important customer's demands.

Here are the key pros and cons of manufacturing in-house:

PROS	CONS
<ul style="list-style-type: none"><li>• Complete control over product quality and scheduling</li><li>• Flexibility to customize processes and output to your needs</li><li>• Higher margins</li></ul>	<ul style="list-style-type: none"><li>• Requires capital for facility and equipment</li><li>• Requires staff, including knowledgeable production management</li><li>• Requires operational structure to integrate offline elements (e.g., procurement, packaging, distribution)</li></ul>

# The Two Foundations of Your Production Strategy

Finding the right production strategy for your product begins with a hard look at two fundamental elements: your objectives and your situation. Together, they can guide your decision-making.

## 1. YOUR SHORT- AND LONG-TERM OBJECTIVES

If you are currently thinking about your production strategy, it's likely that pressing short-term needs or opportunities have pushed you to do so. Maybe you want to assess the market potential of a new product or capitalize on an imminent growth opportunity. Or you need to keep up with increasing demand or improve product quality and consistency. Perhaps higher profit margins are the goal.

Long-term objectives are also key. Do you intend to add to your product line? If so, do you plan to extend an existing product (e.g., flavor variations) or produce an entirely new product type? Do you aim to scale the company over the long-term or are you trying to build a brand asset that you can sell to another company?

Whatever your objectives, the process of articulating and prioritizing them is a critical step in determining the right production strategy for you.

## 2. YOUR FACILITY AND OPERATIONAL SITUATION

Every manufacturer's situation is unique, which means the best choice for one company about producing a product in-house or using a contract production partner may not be the best choice for your company.

### Questions About Your Facility

Start with your facility. Is it large enough—including floor-to-ceiling and doorway space—to accommodate the equipment and people necessary to produce the volume you need in the short-term? What about the long-term? Is there sufficient electrical capacity and water access to run the equipment you need? If you are already making product in the facility, is it designed for efficient operation?

### Questions About Your Equipment and Process

Your equipment and production processes have an enormous impact on your throughput. Is your production vessel(s) the right size? Is the design of your vessel's agitation system efficient for your specific product(s)? Is your heating/mixing/cooling process configured to optimize productivity? Are your upstream (e.g., ingredient loading), and downstream (e.g., unloading, packaging, shipping) processes adequately equipped? It is often possible to generate significantly higher throughput by properly balancing equipment and workflow, so if keeping up with demand is your objective, the extent to which you can improve throughput in your current facility should factor into your decision-making.

### Questions About Your Staff

Staffing is another important consideration. In-house production will require skilled production staff and experienced operational leaders who know how to scale a food production operation. Do you have those people in place, or at least know that you can hire and train them?

Several other factors about your situation will influence your decision to manufacture in-house or use a contract manufacturer. These include the composition of your customer base and your facility's proximity to them; your access to capital to invest in a facility, equipment and people; your tolerance for risk and your timeline.

## **Deciding Between In-House vs. Contract Manufacturing: Three Common Scenarios**

In this section, let's look at three common scenarios where a food producer faces a decision on how and where to best produce their product. While every situation is unique, thinking through some key questions can help a food producer evaluate their production options and determine their best path.



## SCENARIO 1:

### *Start Up Company with Its First Commercialization Opportunity*

Here's a common entrepreneurial story: an individual or a restaurant has a great recipe that constantly garners excitement from friends and family and encouragement to market the product. After successful online pilots or trials at local retailers, a grocery chain agrees to roll out the product to more stores or regions...a real commercialization opportunity!

For new product producers, such sudden opportunities force decisions about production to the forefront. Here are questions to consider as you contemplate the most likely options:

PRODUCTION OPTION	KEY QUESTIONS
Self-produce at a shared commercial or pilot facility	<ul style="list-style-type: none"><li>• How much time will you need to rent to meet your production volume needs?</li><li>• Is additional time available if sales goals are hit and production volume continues to rise?</li><li>• Is there access to knowledgeable and experienced operators, either internally or provided by the facility?</li><li>• How will you meet packaging, labeling and shipping requirements?</li><li>• Will the demand for production personnel leave enough time and resources for you to effectively market the product and grow the business?</li><li>• Does your product need specialized equipment that may not be available (e.g., inclined agitation for ingredients that require gentle blending or folding action)?</li></ul>
Use a contract manufacturer	<ul style="list-style-type: none"><li>• Are you able and willing to commit to minimum production volume and contract length?</li><li>• Can you get guarantees for on-time production?</li><li>• What services will you need from the contractor? (<a href="#">see page 9</a>)</li><li>• How will you manage product quality and consistency?</li><li>• Does your product need specialized equipment from the contractor (e.g., vessel and agitation style)?</li><li>• Will you be able to protect your intellectual property (e.g., recipes)</li></ul>
Build an internal facility	<ul style="list-style-type: none"><li>• Are you able and willing to commit to the investment in building and equipment?</li><li>• Does the anticipated production rate financially justify a new facility?</li><li>• Do you have access to specialized expertise to design and build a facility?</li><li>• Does the building and equipment design need to accommodate future growth or product line expansion?</li><li>• Do you have the staffing resources to operate your own facility?</li><li>• Will the time required to complete a custom facility present a problem?</li></ul>

## SCENARIO 2: In-House Manufacturer with Growth Opportunities that Exceed Its Capacity

Many food manufacturers with in-house production find success in a niche or regional market and then see their products gain traction in a broader market; an ethnic food that becomes popular in the mainstream, for example. This can create a production demand which their in-house capabilities can no longer meet.

Food producers in this situation can consider several production strategies, with these being the most likely:

PRODUCTION OPTION	KEY QUESTIONS
Outsource the overflow to a contract manufacturer	<ul style="list-style-type: none"> <li>• Where should the contract manufacturer be located to optimize marketing, sourcing and distribution efficiency?</li> <li>• What production volume will you require in the first year? How will that change over time?</li> <li>• Does your product need specialized equipment from the contractor (e.g., vessel and agitation style)?</li> <li>• How precisely does the contract manufacturer's process need to mimic your in-house process?</li> <li>• How will you manage product quality at the contract manufacturer?</li> <li>• How will you manage consistency between the contract manufacturer and your in-house production?</li> <li>• How will you manage fulfillment (e.g., labeling, packaging, distribution) in conjunction with your in-house operation?</li> <li>• Will you be able to protect your intellectual property (e.g., recipes)?</li> </ul>
Outsource all production to a contract manufacturer	<ul style="list-style-type: none"> <li>• Where should the contract manufacturer be located to optimize marketing, sourcing and distribution efficiency?</li> <li>• Should multiple production sites be considered?</li> <li>• Can you get guarantees for on-time production?</li> <li>• What services will you need from the contractor? (<a href="#">see page 9</a>)</li> <li>• How will you manage product quality and consistency?</li> <li>• Does your product need specialized equipment from the contractor (e.g., vessel and agitation style)?</li> <li>• Will you be able to protect your intellectual property (e.g., recipes)?</li> </ul>
Expand the current in-house facility	<ul style="list-style-type: none"> <li>• Are there opportunities to improve throughput at your current operation by adding shifts, re-engineering workflow or upgrading equipment?</li> <li>• Do you have experienced professionals who know how to scale your process to larger volume?</li> <li>• Can your facility accommodate additional and/or larger equipment?</li> <li>• Can the utilities at your facility (e.g., electric, water) support greater demand?</li> </ul>
Build a replacement or additional facility	<ul style="list-style-type: none"> <li>• Are you able and willing to commit to the investment in building and equipment?</li> <li>• Do sales projections financially justify a new facility?</li> <li>• Does the building and equipment design need to accommodate future growth or product line expansion?</li> <li>• Where should the new facility be located to optimize marketing, sourcing and distribution efficiency?</li> <li>• Will the time required to complete a custom facility present a problem?</li> </ul>

### SCENARIO 3:

## Currently Using a Contract Manufacturer, but Considering the Benefits of Moving Production In-House

Contract manufacturing relationships can be win-wins for both the producer and the contract manufacturer, allowing each party to focus on what they do best. Yet, even in the most successful situations, it can be worthwhile for the producer to explore the business efficacy of bringing production in-house.

While this type of situation is often driven by financial opportunity, there are many operational questions that must be considered to end up with the best solution:

PRODUCTION OPTION	KEY QUESTIONS
Bring partial production in-house	<ul style="list-style-type: none"><li>• What production volume will you need to produce in-house in the first year? How will that change over time?</li><li>• Can your current infrastructure (e.g., facility, utilities, workforce) support this increased production?</li><li>• Are you able and willing to commit to the investment in building and equipment?</li><li>• Does the building and equipment design need to accommodate future growth or product line expansion?</li><li>• Will moving partial production pose any risk to the quality or performance levels you receive from the contract manufacturer?</li><li>• Does your in-house process need to mimic the contract manufacturer's process?</li><li>• How will you manage fulfillment (e.g., labeling, packaging, distribution) in conjunction with volume your contract manufacturing operation is producing?</li></ul>
Bring all production in-house	<ul style="list-style-type: none"><li>• Can your current infrastructure (e.g., facility, utilities, workforce) support this increased production?</li><li>• Are you able and willing to commit to the investment in building and equipment?</li><li>• Does the building and equipment design need to accommodate future growth or product line expansion?</li><li>• Do you have experienced professionals who know how to design, set up and operate efficient production?</li><li>• Are staffing resources available to operate the expanded facility?</li><li>• Given your product characteristics, what equipment elements (e.g., vessel and agitation style) will optimize the quality, throughput and efficiency for your operation?</li></ul>

In today's production environment, food producers have many viable options to consider. Understanding the implications of each on your product and operation will equip you to make the right decision for both the short- and long-term success of your business.



# What to Know When Choosing a Contract Manufacturing Partner

Contract manufacturers play an essential role in the food industry's production and distribution chain. For many food producers, they provide an efficient and reliable option to produce product and meet consumer demand. To help you explore your options for a production partner, here are some important things to know:

## THE SERVICES A CONTRACT MANUFACTURER CAN PROVIDE

The core service of a contract manufacturer is clear: to make your food product. But here are a few additional services from the contract manufacturer that you may want to take advantage of, depending on your situation.

- *Packaging and Labeling*

The manufacturer can package your product into its final labeled container or in bulk containers from which you can fill.

- *Packaging Design*

Leveraging their experience with other clients, many manufacturers can help design and source your containers and labels.

- *Storage and Distribution*

The manufacturer can deliver product back to you, or store your product and arrange Just-In-Time fulfillment directly to your retail outlets. Some manufacturers operate their own trucking service for standard routes.

- *Consulting Support*

Manufacturers have deep experience working with hundreds or thousands of products. Many offer consulting support to help your business improve its products, identify trends and market opportunities, determine retail strategy and more.

# What to Know When Choosing a Contract Manufacturing Partner CONT.

## FINDING THE RIGHT FIT FOR YOU

Contract manufacturers can be found in all shapes and sizes. Ask questions like these to find partners who match your situation and business.

- ***Who are they making product for now?***  
Look for partners that produce products similar to yours, with comparable quality levels and consumer targets.
- ***How big are they and their clients?***  
If your contractor typically works with bigger clients and larger volume orders, you might get minimal attention or even bumped from the schedule in favor of a higher priority customer. Conversely, if they are too small, they may not be able to keep up with your demand.
- ***Where are their plants located?***  
You can gain efficiencies if the contract manufacturer will be producing your product in the region you will be selling into. These efficiencies can come from lower freight costs, faster delivery times and even from local market knowledge.
- ***How do they manage their business?***  
Look for how serious they take things like quality control, cleanliness and on-time delivery. Learn how they handle things like problem resolution, change orders or product recalls. Find out how long they have been in business and whether their business is trending up or down.
- ***Do they have areas of specialization?***  
It would be helpful to know if they produce products like yours, or products targeted to the same retailers or consumers as yours. Their experience may help you better source ingredients or adapt your product or packaging to improve sales.
- ***What kind of equipment will they use to process your product?***  
Some food products have characteristics that demand specialized processing equipment to get the best results; those with delicate ingredients or high viscosity, for example. Look for equipment, particularly essential components like processing vessels and agitators, that match your products' needs.

# What to Know When Choosing a Contract Manufacturing Partner CONT.

## **DUE DILIGENCE STEPS TO TAKE BEFORE FINALIZING YOUR EVALUATION PROCESS**

The questions on the previous pages can help you narrow your options. Once you have a short-list, you can improve your chances of getting the right fit by taking these steps:

- ***Go for a site visit***  
A tour of the facility will help you see the equipment and validate characteristics like the size and cleanliness of the facility, and the culture of its management and people.
- ***Specify your key product traits***  
Have very specific conversations about the characteristics of your product that will need to be cared for. For example, if it is important for the finished product to maintain chunks of tomatoes or for each jar to have a similar distribution of potatoes, discuss this with the contractor before signing a contract.
- ***Run a few test batches on the type of equipment they would use to produce your product***  
You may have to pay for this step, but it will be worth it to be able to judge the quality of the final product. If possible, attend in person to observe.
- ***Identify important contractual issues***  
Think about the service elements you need to ensure success and make sure they are included in the contract. These can include any item that supports your objectives, such as delivery guarantees, periodic on-site visits, non-disclosure agreements to protect your recipes, or knowledge transfer in the event you want to build your own production capacity at some future point.





## About Lee Industries

The mission of Lee Industries is to assure our customers are successful by focusing on their custom processing needs and providing them with the highest quality, most durable products and services available. Lee Industries is committed to the success of your company by providing you with world-class, high-quality stainless alloy process equipment and service. We design and manufacture the most technologically advanced equipment in the industry. Our customer service team, backed by nearly 100 years of innovation and experience, provides Lee clients with a single source for all their processing system needs.



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