

On the strategic vs. tactic nature of the location choice in the reshoring decision

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Abstract

The phenomenon of reshoring is raising much interest among practitioners and scholars, in particular when this path is undertaken after the failure of an offshoring initiative. While several studies claim that most offshoring decisions are driven by the possibility of enjoying short-term benefits, reshoring projects are rooted in a deeper understanding of the long-term outcomes of a geographically dispersed production footprint. The aim of this study is to investigate why companies decide to repatriate their plants and, in particular, whether such decision is characterized by a higher degree of awareness about its long-term effects. Evidence from eight case-studies is reported.

Keywords: Reshoring, Offshoring, Rightshoring

Introduction

The recent phenomenon of reshoring of manufacturing facilities back to Western countries is leading both practitioners and academicians to a deep analysis of the reasons why several offshoring decisions have proven to be unsatisfactory. While emerging political platforms oriented toward protectionism seem to be one of the main drivers of this new trend, it is becoming more and more apparent that the decision making process behind a location choice is more complex than expected and requires an assessment of several aspects, concerning both exogenous and endogenous factors. In this perspective, the suitability of a location can be different, depending on such conditions as the competitive and functional strategies of the firm, the specificities of its business, the scale of its operations, to mention a few. Recent contributions have started observing the offshoring/reshoring phenomena from the viewpoint of the inherent

decision making process, developing the concept of “rightshoring”, regarded as the process that leads to identify the correct location for a specific company (Tate and Bals, 2017; Joubioux and Vanpoucke, 2016), taking into account all the relevant factors.

The aim of this paper is to understand why companies decide to repatriate their plants and, in particular, whether such decision is characterized by a higher degree of awareness about its long-term effects, which refer to a wide bundle of factors that can determine the success of a location choice. In the remainder of this paper, the literature background will be framed; then the evidence of a case-based study will be reported. Finally conclusions and managerial implications will be drawn.

Literature background

Offshoring, Reshoring and Rightshoring: a brief description

In the recent years several contributions as well as the international business press have highlight the rise of the reshoring phenomenon, regarded as the decision to relocate production activities in the country of the parent company (Stentoft et al., 2016). The scale of such a new trend seems to be relevant. It has been reported that 14% companies endowed with a global footprint are considering reshoring or nearshoring options, and 38% of them think that their competitors have already undertaken this process (Tate and Bals, 2017). The magnitude of these numbers has raised much attention among researchers, who are now investigating this phenomenon from several perspectives, ranging from the reasons behind a repatriating choice, to the most suitable governance structure, to the geographical destination of relocated activities (Fratocchi et al., 2015).

Pursuing a reshoring strategy poses specific problems, mainly concerning where to perform manufacturing activities, and who should be in charge of them, i.e. governance of the production system (Gray et al., 2013). The wide number of combinations of these choices, coupled with a similar degree of variety of the offshore production footprint solutions that a firm can have, clearly shows how complex it is to decide whether and how to relocate. Even the related theories proposed to cope with such problems, namely the Transaction-Cost-Economics and the Resource-Based-View, suggest different and incompatible solutions in particular for the governance structure, thus providing a further confirmation to the inherent complexity of the offshoring/reshoring process (McIvor, 2013).

Offshoring and Reshoring as a location decision

In the operations management literature, the location decision can be observed from the perspective of the strategic alignment approach, according to which the design and management choices that shape the operating system of the company must guarantee an overall consistency among the competitive strategy of the firm, its functional improvement objectives and, ultimately, the hardware and software elements of its production system (Belvedere and Gallmann, 2014; Wisner and Fawcett, 1991; Leong et al., 1990; Skinner, 1969). Several contributions have argued and empirically demonstrated that when such an alignment is not achieved the ability of operations to positively contribute to the competitiveness of the firm can be threatened, as is the case of companies that adopt managerial practices or IT systems popular in a given period of time, without checking whether the operational performance improvements brought about by these investments are actually in line with their value proposition to the customer (Dixon et al., 1990). In this concern, both the offshoring and re-shoring decisions peculiar to the recent years can be seen as “cures” common to many firms

that, in the case of offshoring, are mostly willing to take advantage in particular from cost cutting opportunities coming from location choices in emerging countries (Gylling et al., 2015; Tate 2014; Tate et al., 2014; Gray et al., 2013), and in the case of reshoring want to achieve such results as increasing the responsiveness of their logistic processes and/or more properly dealing with pressures exerted by the stakeholders as far as environmental and social sustainability issues are concerned (Ellram, 2013; Ellram et al., 2013; Gray et al., 2013).

If we frame the offshoring/reshoring decision in the strategic alignment process, it is first of all necessary to outline the operational performances that can be influenced by the location decision, that according to a widely accepted taxonomy, concern cost, quality, time and flexibility (Neely et al., 2005). On top of these attributes, recent literature has also highlighted the remarkable effects that operations and logistic processes can have on the environmental and social performance of the company, which is now accepted as the fifth performance dimension of such processes (Belvedere and Grando, 2017; Elkington, 1997).

Indeed, extant contributions have highlighted how most decisions to repatriate production activities aim at overcoming problems determined by previous offshoring projects whose overall impact on the above mentioned performance attributes was unfavourable (Stentoft et al., 2016).

However, according to Fratocchi et al. (2015), several decisions of re-shoring are not rooted in mistakes made by the company when addressing the location decision, but in changes in the business environment and in firm's specific factors. The former can refer to cultural differences, changes in fiscal policies, availability of new production technologies, reduction of productivity gaps among countries or unfavourable trends in the exchange rates of currencies or emerging political choices aimed at reinforcing the internal production, as America's reshoring policies after Trump's election (Fratocchi et al., 2015; Stentoft et al., 2015; Arlbjorn and Mikkelsen, 2014; Tate et al., 2014; Ellram et al., 2013; McIvor, 2013). Firm's specific factors, in turn, may include the proximity to R&D centers that can foster the innovation capabilities of the firm, risks of Intellectual Property leakages, the strategic value of the "Made in", necessity to be closer to the client (Joubioux and Vanpoucke, 2016; Fratocchi et al., 2016; Stentoft et al., 2015; Tate, 2014; Tate et al., 2014; Gray et al., 2013).

Methodology

The review of the operations management literature concerning offshoring and reshoring choices highlights the existence of a number of drivers of their success and of conditions that must be met in order to get the most from a location choice. These can be synthesized as follows:

- Strategic alignment of the location choice with the competitive strategy of the firm and with its operations strategy;
- Business environment's conditions, which refer to changes in exogenous factors that can affect the outcome of a location decision;
- Firm's specific factors, referring to specificities of the industry and to situations in which, even though the location decision can actually support and strengthen the operations strategy of the firm, on the other hand it can be detrimental of other functional performances (e.g. those concerning R&D activities and Marketing & Sales ones).

In this setting, the offshoring and reshoring choices can be seen as outcomes of a decision making process that, when properly carried out, can even consist of giving up offshoring options. Thus, we assume that location failures are going to occur when one

or more of these factors are overlooked or undervalued. Addressing this issue is relevant because, on the one hand, some of the above mentioned factors have not been adequately discussed in the extant literature (Bals et al., 2016; Fratocchi et al., 2015). Furthermore, the remarkable number of failures in offshoring initiatives, which are now leading to reshoring or nearshoring projects, demonstrates that the inherent decision making process is still performed with a tactic rather than strategic approach (Tate and Bals, 2017; Bals et al., 2016; Joubioux and Vanpoucke, 2016).

To conduct this study, a multiple case-study approach has been adopted, which is the most suitable methodology for the aim of this paper (Yin, 2003). The empirical evidence has been analysed through the pattern matching approach (Yin, 2003). Thus, on the basis of the extant literature, we have developed the reference framework represented in Figure 1.

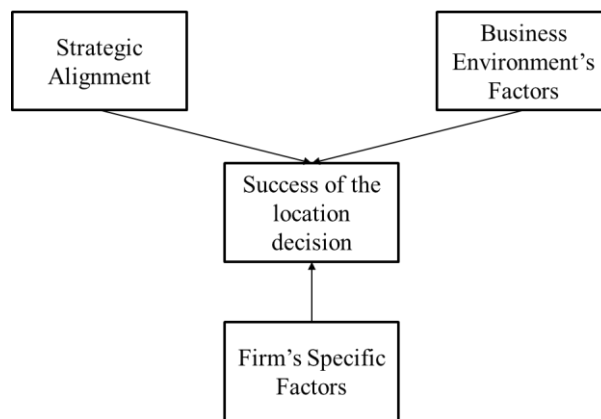


Figure 1 – The reference framework

Totally we have included in this paper 8 case-histories. In all of them, the unit of analysis was a specific location decision taken in the recent past (offshoring or reshoring). In the cases where no offshoring project has ever been experienced in the recent past, or when it dated back to several years ago, the unit of analysis was the production footprint in its current setting.

Interviews and data collection were carried out according to a research protocol aimed at addressing the main constructs in the reference framework. For this aim, the operations manager was interviewed as well as managers directly involved in the location decision or able to report about its history and outcomes.

Empirical findings

Company A

Company A was established nearly one century ago in a famous Italian eyewear district, where it started producing eyeglasses' cases initially for the national opticians and, since the '30s, also for foreign clients.

The '80s were the years of remarkable growth for the Company, due to the advent of luxury firms that started licensing their brands to eyeglasses producers, with an evident positive effect on their supply network. In this period the OEM Division was created to properly deal with the specificities of the eyeglasses producers and, to cope with the increased demand, four new production plants were established and one in Romania was acquired. In the same period commercial branches were opened in USA, first, and then in Germany, France and Hong Kong. In 2003 a new product line was launched, concerning leather goods and accessories. Due to the relevant increase in the volumes,

Company A decided to establish a new plant in China for the production of cases, so as to take advantage from the low cost of labour, which is a major cost driver in this industry given the nature of the production process. However, the higher and higher relevance of speed for the competitiveness of the eyeglasses firms, Company A has considered a “near shoring” option, consisting in moving the production volumes allocated the Chinese plant back to Europe, in particular to the Romanian factory.

Company B

Company B is a big player of the aerospace/defence industry and, for the purpose of the study, the unit of analysis was the aircraft division. The activities carried out by such a division range from the design and development of the vehicle, to its production and final test, with a remarkably high degree of vertical integration. Even though the Company operates on a world-wide level, its production footprint is mostly national and its supply base encompasses a majority of Italian suppliers (nearly 90%), whose selection depends first of all on the quality level that they can grant, and then on their operational flexibility and costs. Due to the extreme relevance of product quality and to the tight regulatory constraints peculiar to this industry, only low value-adding operations are outsourced, which involve the production of standard parts. Thus the phenomenon of offshoring takes the form of outsourcing options managed with an opportunist approach, whose adoption is possible because of the nature of the activities carried out by the suppliers. This kind of organization is considered reliable and is not going to be modified in the near future.

Company C

Company C was established in the ‘50s as a wool mill, but eventually extended the scope of its activities also the production of fabric targeted to the main international high end fashion companies. Due to this strategy, in the ‘60s Company C enjoyed a remarkable increase of sales on both national and international markets and, as a consequence of this expansion, it decided to secure the availability of good quality raw materials through the acquisition of several South-American suppliers.

Eventually this Company launched a new product line of apparel products, with an operations system characterized by a high degree of vertical integration, from the yarn to the final production of apparel items sold mainly through directly operated stores. However, in response to the need of a higher degree of flexibility necessary to cope with the evolution of the competitive arena of the fashion industry, Company C undertook an outsourcing process aimed at delegating all of the production stages of the apparel items to a wide network of suppliers and subcontracts based in Italy. This choice has been confirmed even when the Company was acquired by a major Italian player of this industry in the late ‘90s. The adoption of a national production footprint relies on the necessity to guarantee the “Made in Italy” label. For the near future no relevant changes will be made to this organization.

Company D

Company D was established in the ‘60s as a producer of thermoplastic and rubber components mainly for the automotive industry and, more recently, for the home appliances one. The footprint of the Company is characterized by a high degree of internationalization, obtained over the years through the establishment of several manufacturing plants, the location of which has been influenced primarily by the necessity to achieve a high proximity to the clients to guarantee product customization. The company is active also in low cost countries with owned production facilities, but

this is not due to the opportunity to take advantage from the low cost of local resources, being the production process highly automated. All plants show a high degree of vertical integration, regardless of their location. This is due to the possibility of exploiting the deep internal know-how concerning both the products and the processes, which lets the Company reach outstanding levels both of product quality and production efficiency.

Company E

Company E is small firm active in the fashion industry and specialized in high end menswear. Although the company was established in the '60s, its first collection with own brand was presented in the '80s and, since then, it gained a solid commercial position in several foreign countries, in Europe, Asia, North and South America. Currently most of the turnover is driven by the export.

Although the design process is managed in the headquarter in Milan, all production activities are outsourced to suppliers, which are located exclusively in Italy. Nearly ten years ago, Company E experienced a process of off-shoring, namely with the aim of establishing a partnership with an Indian large corporation. However, this project soon turned in a failure due to several reasons. First of all, in order to guarantee a high enough level of efficiency in the Indian production, the batch size should have been at least as double as the average order quantity placed by Company E. Furthermore, product quality was not in line with the standards of the Company and its management team soon realized the need of having its own quality control manager at the site of the Indian supplier. However, this solution was unfeasible for a company like E, endowed with a rather small management team. Consequently, two years later Company E reshored its production.

Italy's share of the world's clothing, textiles and leather industry has declined significantly since the 1980s.

The wage gap between the largest European economies and Asia is still wide, but advancements in some EU countries' productivity in recent years are diminishing the advantage. At the higher end of the market, brands are focusing on quality linked to the 'Made in Italy' brand. At the lower end, where cost remains a key driver of sales, there will unlikely be a significant reshoring impact.

Company F

Company F is a major brand of canned tuna, owned by an Italian multinational company active in the fast moving consumer goods industry. For the production of canned tuna, the Company has adopted an organization characterized by suppliers of raw material located in foreign countries, where tuna is fished. Such vendors are also in charge of the initial steps of the production process that encompasses the cleaning and steaming of tuna loins, which are later frozen and shipped to Company F in Italy. Once received by the Italian factory, tuna loins are (mostly, olive oil) packed and sterilized. The production footprint adopted by Company F is different from the one of most competitors, which have fully outsourced the production process to their foreign suppliers, so as to take advantage from cost cutting opportunities. On the opposite, Company F has chosen to compete on the quality of the product, which would have been poorer with a fully outsourced transformation process. Furthermore, by carrying out the final production activities in Italy, it is possible to better cope with the increasing products' differentiation (size, product origin, preserving agents, etc.) and trend and demand volatility, adapting the production volumes to the actual orders placed by customers. Finally, the production footprint of Company F allows a higher degree of

product flexibility, which results in the ability to bring to the market innovative items as lighter (in calories) products, salads and mixes, whose developments generally requires the proximity of the factory to the market and to the R&D centers of the company.

Company G

Company G was founded in 1952. Since then, it grew steadily both organically and through acquisitions to become worldwide leader in precision equipment for measurement and control in the production environment.

More precisely, company G provides standard and custom systems for industrial applications to measure and control dimensions, geometries and surface quality of mechanical components and for control and monitoring of the machining process. Its main customers are machine tool makers that sell machines already equipped with gauging systems; gauge makers that buy measuring components to manufacture stations for end users and end users. Currently 70% of the production volume is sold to the automotive industry. Sales and Technical Support companies are in 24 countries with 80 offices. A further 9 countries benefit from dedicated networks of Agents and Dealers. Thus, sales abroad (China, Japan, Germany and the U.S.) make up as much as 94% of Company G total revenues worldwide. Most of the production is made in three main manufacturing locations, in Italy, in China and Korea, but also the acquired companies (in Italy, Germany, France, the US) have their internal manufacturing organizations with the capability to customize, or sometimes to design and produce, specific solutions for their local market: this meets the principle to be present in all the places where customers operate and be closest to their way of thinking.

The largest plant outside Italy was originally established in China in joint venture with an automation company in 2006. In 2008 Company G bought out the partner company stake in the Chinese joint venture and currently has three divisions developing very fast and establishing a good relationship with an increasing number of local car manufacturers, providing them with tailor-made products and service. The reasons why Company G decided to establish the manufacturing plant in China referred to the low cost of labour, the possibility of serving a new fast growing market (the Asian one) and need of producing dedicated systems originally based on old generation cheaper technologies. Until now, the experience made in China is positive and also the product quality, which was a critical issue at the beginning of this offshoring process, has been later overcome.

Company H

Company H is one of the world leaders in ceramic tiles for both floor and wall use. It was established in the '60s in the tile district of Sassuolo – one of the largest Italian industrial districts. From its incorporation the company has led research into raw materials and production processes.

During the '90s the company grew through horizontal acquisitions and investments both in distribution and production activities. Among the latest, the most relevant were a production plant in the U.S. and a logistic centre in Brazil. Currently most of the turnover is driven by the export. The development of the U.S. plant started in 1991 with an equity partnership (15%) with a Thai group (among the world leaders in building materials), which already owned a 10% stake in the Italian group. However, in 1994 Company H decided to dispose its stake in the U.S. company, but the financial difficulties of the Thai partner created the conditions for a total acquisition of the U.S. production facilities in 2000, followed by the acquisition of the U.S. distribution activities. These investments allowed the firm to grow strongly internationally and

aggressively target the US market and the Southern-American market with the support of the Brazilian logistic centre.

Products made under the Company H brands are sold to top customers and importers all over the world leveraging a favourable competitive position allowed by the associated use of the two centres of production based in Italy and the U.S. The location of the production activities guarantees proximity to the clients, consistent cost reduction and product customization thanks to the tight links with the distribution activities.

Cross-case Analysis

The main outcomes of the case-studies are reported in Tables 1a and 1b, which briefly describes the size of the company, its competitive position, the unit of analysis of each case study (i.e., offshoring project, reshoring project, current production footprint) and the relevant factors (among those described in the reference framework in Figure 1) that have determined the success/failure of the project or have moulded the current footprint. In particular, for each typology of factors, we have reported those aspects that drove the initial location decision and/or that determined its success/failure.

Table 1 a – Synthetic Information on the Case Studies (A to D)

	<i>Case A</i>	<i>Case B</i>	<i>Case C</i>	<i>Case D</i>
<i>Firm Size</i>	Medium	Large	Small	Medium
<i>Firm Competitive Position</i>	World leader	Among the world leaders	Niche	World leader
<i>Unit of Analysis</i>	Reshoring	Current Footprint	Current Footprint	Current Footprint
<i>Strategic Alignment</i>	- Speed - Responsiveness - Mix flexibility	- Quality	- Product flexibility	- Product flexibility
<i>Business Environment Factors</i>	- Higher relevance of responsiveness		- Higher relevance of responsiveness	
<i>Firm-Specific Factors</i>		- Regulation	- Made in Italy - Proximity to the client	- Proximity to the client

Table 1 b – Synthetic Information on the Case Studies (E to H)

	<i>Case E</i>	<i>Case F</i>	<i>Case G</i>	<i>Case H</i>
<i>Firm Size</i>	Small	Medium-Large	Large	Large
<i>Firm Competitive Position</i>	Niche	Niche	World leader	Among the world leaders
<i>Unit of Analysis</i>	Reshoring	Current Footprint	Offshoring	Offshoring
<i>Strategic Alignment</i>	- Quality	- Quality - Volume flexibility - Product flexibility	- Cost	- Cost - Product Flexibility
<i>Business Environment Factors</i>	- Increasing productivity gap			
<i>Firm-Specific Factors</i>		- Proximity to the client		- Proximity to the client

As can be seen in Tables 1a and 1b, all companies observed in this study have widely discussed on the relevance of the “Strategic Alignment” factors in the location decision. Indeed, regardless of the unit of analysis, all interviewees argued that a major driver of the decision concerned the necessity/opportunity to improve at least one operations performance. Among the most frequently cited, cost, product quality and flexibility (in its various forms) seem to be the most relevant areas of concern, the underrating of which can determine a later reshoring decision or even the decision to give up an offshoring option.

“Business environment’s factors” (regarded as changes occurred in the industry) have been mentioned by three companies (A, C and E), which reported on the changes of the fashion industry, which they belong to. Indeed companies A and C told about the increasing relevance of the concept of market responsiveness and continuous innovation, which require prompt production and delivery processes. While this evolution has recently led Company A to nearshoring its production, Company C has decided not to make any change to its production footprint, already based in Italy. On the other hand, company E highlighted that the increasing productivity of western countries, compared to eastern ones, is making the offshoring option less attractive.

Moving to the “Firm’s specific factors”, two cases (B and C) made an explicit reference to the specificities of their industries, which are, in the former, the tight regulatory system, and in the latter the relevance of the “Made in Italy” label. These factors have led both companies to the decision of keeping their production system in Italy.

Within the “Firm’s specific factors” also issues concerning the interfaces of operations with other functional areas of the company are included. This condition has been mentioned by four companies (C, D, F and H) and in all cases the relevance of the proximity to the customer was highlighted. Indeed, the necessity to cope with demand volatility (interface with Marketing & Sales) and to adapt products to the needs of local clients (interface with R&D) is becoming more and more relevant and is resulting in remarkable outcomes on the production footprint.

Conclusions

The preliminary evidence stemming from our study confirms that all the factors in our theoretical framework play a role in the decision making process concerning the location choice. We also show that the success of this choice depends on the degree of awareness on its long term outcomes. Our study demonstrates that the final choice and its outcomes depend on the specific mix of factors that the company copes with.

In this concern, it could be worthwhile further investigating on the correct sequence in which such factors and enabling conditions should be considered in the decision making process, in order to immediately drop possible initiatives that are unsuitable for the company, even though they could theoretically contribute to strengthening the operational performance. On the opposite, our study shows that most attention is devoted to the “Strategic alignment” factors, while the others gain relevance in a later stage, when an investment has already been done and can be hardly reversed.

Being based on a qualitative analysis conducted across eight cases, this study suffers from the limitations peculiar to such a research strategy (Yin, 2003). Although our paper points out some remarkable findings about this issue, we cannot exclude that further factors can actually play a relevant role in this decision making process.

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