Subcontracting: Competent award of services and manufacturing orders to external partners

Subcontracting refers to the transfer of tasks, processes or manufacturing services to external companies that perform them under their own name or to a detailed specification. In industrial procurement, the term covers contract manufacturing, specials procurement and the outsourcing of entire business processes. How subcontracting is designed determines the cost structure, capacity flexibility and dependence on suppliers.

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Key facts at a glance

01 Subcontracting covers both the placing of manufactured parts (work by contract) and the outsourcing of services and processes.

02 Typical forms are toll and contract manufacturing, contract manufacturing and business process outsourcing.

03 The core decision is the make-or-break or make-or-buy scenario with a complete cost and risk assessment.

04 Legally, subcontracting creates a supply or works contract, but not an employment-law transfer of the services.

05 Quality is frequently safeguarded through material approval, first article inspection and ongoing supplier evaluation.

06 Export-oriented awards may require evidence of the contractor's AEO status for certain countries.

Definition: Subcontracting

Subcontracting is the complete or partial transfer of internal company tasks to external service providers or manufacturers who deliver defined services for payment. It is therefore an instrument for shaping value creation and is closely linked to procurement strategy.

Distinction from supplier procurement

In classic supplier procurement, the buyer purchases standardised goods from a supplier's product range, for example from a parts catalogue. In subcontracting, the commissioning party hands over its own design, drawing or specification and has it produced to that specification. The contractor thus becomes an extended arm of the company's own production, which places considerably deeper demands on specification, quality assurance and confidentiality.

Subcontracting, outsourcing and offshoring

The terms are often used synonymously but differ in detail. Outsourcing describes the long-term transfer of entire functions such as IT, accounting or cleaning. In an industrial context, subcontracting usually means the one-off or series award of manufacturing services, also known as contract manufacturing. Offshoring, finally, is a geographical variant and relocates the service to distant countries – typically with opportunities in unit costs but increased logistics and quality risks.

Decision and methods: When does subcontracting pay off?

The foundation of any subcontracting arrangement is a structured make-or-buy analysis. It assesses not only the pure manufacturing costs but also capacities, technology access, staffing situation, protection requirements and strategic dependencies.

Make-or-buy analysis

The analysis compares in-house production and procurement on the basis of total costs: material, manufacturing, set-up, quality, freight and administrative costs as well as investment-related fixed cost blocks. In practice, it frequently emerges that in-house production only becomes economically viable beyond certain volume thresholds. Soft criteria are weighted equally: know-how protection, feasibility during demand peaks, demand fluctuations and the reluctance to give up critical competencies.

Requirement specification and scope of services

Without a precise requirement specification, no subcontracting can be controlled. This includes technical drawings, tolerance specifications, material specifications, surface definitions, test instructions and, where applicable, relevant standards. The clearer the specification, the more comparable the bids and the lower the potential for disputes over rework. In practice, standardised requirement specification formats and a structured bid comparison with uniform assessment criteria have proven their worth.

Award procedure and solicitation of bids

Once the specification has been defined, market sounding follows and enquiries are sent to suitable contractors. A systematic bid evaluation compares not only price but also information on capacity, lead time, machinery and qualifications. Where expertise is lacking in procurement, for example in assessing manufacturing processes, technology assessment in procurement provides decision support. The source-to-contract (S2C) process structures the path from enquiry through award to contract signature.

Key KPIs for managing subcontracting

Subcontracting can only be managed if its performance remains measurable. Buyers and supply chain managers therefore use a mix of cost, delivery and quality metrics.

Delivery and process metrics

The focus is on the contractor's on-time delivery, quality rate and lead time. In practice, on-time delivery above 95 per cent is considered a solid level in contract manufacturing; as regards scrap, common benchmarks depending on the industry range from a few per mille to a few per cent. In addition, inventory coverage shows whether agreed safety capacity or pre-production is being put to good use or can retrospectively be assessed as risk mitigation.

Cost control and renegotiation

The target-actual price comparison makes deviations between estimated and actually invoiced items transparent – for example material surcharges, special tools or additional effort. For longer-running contracts, renegotiation is customary when raw material prices or volumes shift significantly. Payment terms such as early payment discount calculations and shortened payment terms such as 2/10 net 30 also significantly shape the economic viability of subcontracting in practice. For complex multi-currency transactions, currency hedging (FX) is added.

Supplier evaluation and maturity level

A structured supplier rating combines hard facts such as on-time delivery and complaint rates with soft facts such as responsiveness and willingness to cooperate. In addition, a structured technology assessment in procurement shows whether a contractor remains capable when requirements increase – for example through tighter tolerances, new materials or larger lot sizes. In practice, regular assessment cycles are recommended in order to identify trends at an early stage.

Risks and controls in subcontracting

Subcontracting does not eliminate risks but changes them: instead of the company's own production risks, dependencies, information asymmetries and quality fluctuations emerge. Systematic controls significantly mitigate these risks.

Supplier risk and safeguards

Insolvency, capacity bottlenecks or quality deterioration at the contractor directly threaten the company's own ability to deliver. Structured supplier risk management therefore assesses the situation, financial resources, utilisation and country risks of partners before awards are made. For critical orders, it is common practice to obtain security via a bank guarantee/surety bond – especially for advance payments, pre-financing or long lead times. Where parts are delivered abroad, the partner's AEO status is a recognised indicator of reliability in foreign trade for the relevant destination countries.

Quality assurance and material approval

Before series production and after every relevant process change, a formal material approval must be obtained. Typically, a first article inspection with measurement report is agreed; in highly regulated industries, production process approvals and audits are added. Subsequent complaints should not merely be complained about but systematically converted into evidence preservation and corrective actions. Missing documentation devalues later claims.

Obsolescence and succession planning

Anyone subcontracting components on a long-term basis must ensure that materials and documentation do not disappear from the market. Mandatory obsolescence management at the contractor – including advance warning periods and alternative sources – is therefore an established component of larger framework agreements in practice. In addition, a contingency strategy is advisable: at least one second qualified supplier should be identified before an actual failure occurs.

Contract and compliance topics

Alongside classic warranty and liability clauses, sustainability and reporting requirements are gaining in importance. The Corporate Sustainability Reporting Directive (CSRD) increases the documentation pressure along the supply chain; affected companies need robust information on the origin, energy intensity and CO relevance of subcontracted services. Tax and trade issues such as transfer pricing in international subcontracting should in principle be reviewed on a case-by-case basis with the relevant specialist advisers.

Current developments and digital tools

Subcontracting is shifting from pure price competition towards closer cooperation and digital transparency. Data quality, platform exchanges and sustainability requirements shape the current agenda.

Digital award platforms and data quality

Online marketplaces and procurement platforms considerably shorten the path from requirement specification to order placement. What determines their usefulness is data quality: drawing statuses, bill-of-materials logic and material data must be machine-readable and up to date. A structured data quality report reveals which items can be reliably tendered at all – and where internal rework is needed first.

Cost transparency

Increasingly, commissioning parties and contractors agree open-book costing: the underlying cost items – material, manufacturing minutes, overheads – are presented transparently and reviewed jointly. This facilitates factual renegotiations and prevents price discussions from failing due to a lack of traceability. Supplementary Incoterms agreements such as CPT also regulate unambiguously at which point transport risk and costs transfer.

Resilience, regionalisation and sustainability

Experience with supply chain-driven shortages has increased the willingness to position critical subcontracting more regionally – even at moderately higher unit costs. At the same time, the sustainability of contractors is coming into focus in evaluation; criteria such as energy origin, CO intensity and social standards are moving into metrics and audits. Those who systematically anchor these requirements reduce reputational and regulatory risks and prepare reporting along CSRD requirements efficiently.

Typical metrics

Metric	Typical value
Contractor on-time delivery	> 95 % *typical target value in contract manufacturing environments*
Complaint rate	< 1 % *industry-dependent; significantly stricter for critical parts*
First article approval rate	> 90 % *share of sample parts approved on the first attempt*
Target-actual price deviation	< ±3 % *typical tolerance range for invoiced items*

Practical example: Contract manufacturing at a mechanical engineering company

A medium-sized mechanical engineering company with around 350 employees faces rising demand for welded assemblies and decides to award partial volumes to external metal fabrication companies.

- A make-or-buy analysis based on full process costs indicates a volume shift of around 40 per cent of the relevant assemblies.
- Tendering via a standardised requirement specification, followed by bid evaluation using uniform assessment criteria including a technology assessment of the candidates.
- Agreement of first article inspection with measurement report, defined safety capacity with two partners and ongoing supplier rating with monthly on-time delivery evaluation.
- Additional safeguards: bank guarantee/surety bond for pre-financing and documented obsolescence management for long-lived drawing parts.

Conclusion

Subcontracting is more than a cost instrument: it changes capacity headroom, competency profile and risk exposure alike. Successful awarding is based on precise requirement specifications, sound bid

evaluation and measurable management of contractors. Those who consistently embed supplier risk management, material approval and obsolescence management retain control even in strained supply chains. Digitalised award processes and robust data quality noticeably reduce the administrative effort. This turns subcontracting from a stopgap into a strategic lever for shaping value creation.

Frequently asked questions

? What does subcontracting mean in simple terms?

Subcontracting means that a company outsources tasks, manufacturing or processes to another company instead of carrying them out itself. The contractor usually produces to the drawing and specification of the commissioning party. This keeps the cost structure more flexible, but creates dependencies and quality risks that must be managed.

? When does subcontracting pay off rather than in-house production?

Subcontracting pays off when in-house production reaches capacity limits, technologies or certifications are lacking, or demand fluctuates heavily. The deciding factor is a make-or-buy comparison covering total process costs, not just the unit price. Many companies retain strategically important know-how and critical components in in-house production.

? What are the risks of subcontracting?

Typical risks include failure or insolvency of the contractor, quality deviations, loss of know-how and increased dependence on a small number of providers. These can be significantly reduced through supplier risk management, first article inspection with material approval, second-source strategies and security instruments such as a bank guarantee/surety bond. Contractual protective clauses are also essential.

? What is the difference between subcontracting and outsourcing?

Outsourcing usually refers to the long-term transfer of entire functions such as IT, logistics or finance to external service providers. In industrial usage, subcontracting is broader and includes in particular the award of manufacturing services or sub-processes on a contract basis. The two terms overlap but are used differently.

? Which KPIs are important in subcontracting?

Key metrics are on-time delivery, quality or complaint rate, lead time and the target-actual price comparison. In practice, on-time delivery above 95 per cent and scrap rates in the low per-mille range are considered a good level, depending on the industry. In addition, supplier rating and inventory coverage help to track trends and assess buffers.

? How do you find suitable contractors for subcontracting?

The usual route is market sounding, an invitation to tender with a clear requirement specification, followed by bid evaluation using uniform assessment criteria. Evidence of capacity, qualifications, quality systems and, where applicable, certifications such as AEO status is important. Digital

marketplaces and supplier portals considerably shorten this process.

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