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Strategic Pillars in Make or Buy Decision Making : A Position Paper

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ABSTRACT

Make or buy decision is one of the input techniques for management practice. Due to global outsourcing, make or buy decision has become popular and frequent. Continuous increase in the normal of manufacturing and service industries across the globe has made numerous number of suppliers offering products and services for a less price. This has improved the global product and service markets by giving the consumer the ultimate advantage. The decision involves various departments in the production process. Yet make or buy decision is not without its intricate conundrums. This review evaluates the convergence of experiential wisdom regarding make or buy decision making points. We conclude by pre-empting the debate to explore other hidden dynamics of make-or-buy decisions (especially in a constantly changing global economy) and present time tested and more robust integrated framework to help companies make the right decisions.

Keywords : Shareholders, Decision Making, Qualitative factors

I. INTRODUCTION

Make or buy decision can be expressed as the strategy of the firm to decide, if to manufacture its own products or offshore to an external firm. Firms embarking on this strategy considers not only the short term but also the long term future of the firm and how it going to survival if there is a change in the business environment it find itself. Firms find themselves in situation on how to utilize their resources to create more product and service internally for customer satisfaction (Mudambi, 2010; Vinhas, 2002). Firms are expected to produce goods and service consistently based on the firms' objectives. What decision makers keep asking is what the firm should produce internally and purchase externally, this was considered on cost only, but modern business environment has proven that the decision goes beyond cost but also a firm strategy, staff competency, manufacturing process and well guided supply chain process etc. Firms that considered the named factors during decision making enables them to make effective comparison when it comes to buy or make decision (Williamson, 2005). During the decision making process, the departments involved put into account both the quantitative and qualitative aspect of make or buy decision which includes: quality, reliability and how the decision taken is going to affect the activities of the firm, suppliers and customers either positively or negatively (Platts et al., 2002; Fin & Whitney, 2002; Water and Peet, 2006).

Besanko (2003), thought that make or buy decision emphasis on how firms are going to utilize their resources for higher profitability, doing so, firms focus on how to contain the cost involved, enrichment of core competency and an increase in firm efficiency (Anne, 2007). Organization that deal with large volume of customers, may want to make or buy some of their products, based on the time that requests are made by their customers. There have been increasing challenges for firms across the nation with huge volume of customers and firms believe that a firm can overcome this issues either by deciding whether to make or buy, since this can reduce the workload or overcome any inefficiency in the ordering, production and delivering process (Moses, 2011; Mantel et al., 2006).

Make or buy decision is based mainly on five main strategies namely: Product strategy, quality strategy, cost and finance strategy, manufacturing technology strategy, supply chain management and logistics strategy. The precedence of the strategies mentioned above are based on the contractual agreement and the information obtained for the decision by the managers of all related departments within a firm. The various departments involved in the decision making process investigates and summarizes the result of each main criteria according to firm priorities (Saaty, 2006; Saaty and Traan, 2007).

II. DETERMINANTS OF THE MAKE OR BUY DECISION

The modern market environment is widely opened and dynamic in nature, with the demand for product and services very higher, this has compelled firms to decide and reconsider make or buy decision, that does not only rely on the idea of cost but incorporate several factors such as skills, knowledge and ability to decide on the perceived strategy (Balakrishnan and Cheng, 2005).

Crosby (1986), suggested that for a firm to determine whether to produce a product or service internally (make) or externally (buy), it's very demanding and critical activity that requires a well thought member to decide on which strategy is appropriate for the firm to follow. This decision involves both qualitative and quantitative factors. The decision-making process puts both the short term and long term viability of the product into consideration. Since the market keeps changing, there might be a possible change in how the process or product need to be done to suit customers need. The Qualitative factors comprise of the status and reliability of the suppliers, the long-term outlook regarding production or purchasing the product, and the possibility of changing or varying the decision in the future and the probability of changing or reversing the decision in the future (Wilkinson, 2013).

Make or buy decision can be determined by the environment of the firm in which it operates. The changes in the environment determines what firm should produce. The location of the firm is very necessary when making such decision, it has become necessary for firm to understand and have a clear view about the market they operate within since it can change their decision in either to make or buy (Capitanio et al., 2009; 2010). Make or buy decision taken by firms enable them to grab up-to-date technology, knowledge and skills about how modern business in that field is done and so making firms manage to overcome rise associated with cost (Ulset, 1996; Gooroochurn and Hanley, 2007). Though make or buy decision might have some risk attached to it, when the laid down organizational objectives are followed, firms stand the merits of less cost, develop ability to adapt to any situation or environment, technological outflow etc., though this might incur some cost but might be important for higher competitive advantage (Love and Roper, 2005; Howells et al., 2008; Gooroochurn and Hanley, 2007).

Companies' inability to produce or easily acquire products or services compel them to either engage in make or buy decision strategy. Capability which involve staffs, machines and well established departments that are to foresee the process are in a decline position, this will encourage firms to undertake the buy aspect of the decision. When the various capabilities are in full utilization firms decide to produce their product internally (Nooteboom, 2004). Consumers prefer product with cheaper price and fit for the purpose they are buying, this compel firms to weigh the cost involved either to produce internally or externally. Firms tend to seek for suppliers with similar or same operation for low cost and faster services. Firms compare the suppliers cost with their internal production cost before deciding on which action to embark upon for sustainability in the business market.

Technology plays a key role in deciding what to produce internally and externally. Firms peg it production to the technology available and to the demand from customers, when the technology is outdated the firm should buy new technology to improve upon it activities or outsource it production to outside firm. Technological improvement brings about high productivity since it keeps the firm updated with current market trend. Technology enable firms to implement innovative ideas for higher competitive advantage and higher ability in producing. Updated technology enable firms to set their priorities right in deciding what should be manufactured first or to be outsourced based on customer visibility or market differentiation, the most important thing is what customer or what differentiates their product in the market place (Abetti, 1989; Shapira, 1998; Canez and Probert, 1999).

III. RISK AND BENEFIT OF MAKE OR BUY DECISION

Make or buy decision enable firms to be flexible strategically, which is essential to firms doing business in a vibrant market. Strategic flexibility enable firms to respond quickly to the market changes and enforce updated technologies that enable firms to be competitive (Abrahamson, Brege and Anderson, 2003; Gilley and Rasheed, 2000).

Risk encountered by a firm mostly comes in the form of connection and marketable risk. The connectional risk is attributed to the performance of the supplier. Firms must ensure that the vendor will present the necessary process capable of producing the required activity (Weele, 2005), this has raise the importance of understanding make or buy decision. The make or buy decision process can affect delivery service and unforeseen cost can occur in an outsourcing alliance (Brown and Wilson, 2005). Supplier performance risk arises during the make or buy decision process which emphasis on identifying what the vendor can perform, what was agreed upon in the contract, if they have enough resources and capabilities, and if the right quality can be delivered at the right time (Weele, 2005; Brown and Wilson, 2005). Firms might accumulate extra cost on work that is done externally and this is referred to as commercial risk.

The inability of a firm to have control over their partners can generate high risk in the make or buy decision process (Raiborn et al., 2009). This inability might be thus that the vendor has more partners to attend to and decides to attend to others than you (Sanders et al., 2007). Firms stand the risk of immediate substitute or high rivalry exist between the firm and other companies, this can lead to lower competitive strength, as suppliers get more customers, ideas might be transferred to them which make companies stand possible risk of losing market shares (Abrahamsson, Brege, and Andersson, 2003; Gilley and Rasheed, 2000; Weele, 2005). Companies stand a risk of making known their core competence to competitors, other firms might meet firm core competence and it hard for firms to foresee their core competence.

Firms are unable to innovate due to outsourcing activities. Firms feel relax to develop new idea about how products are to be made or bought and this might lead to poor innovation abilities (Massoud, 2009). Being unable to innovate prevent staffs from exhibiting their skills and keep on with the old skills, especially when firm outsource what should be produced internally. It is necessary for firms to be dynamic in nature but make or buy decision activities might hinder the firm's ability to change when the business environment changes. Outsourcing most of your activities might lead to low value of products. Problem concerning negotiation with the supplier for cheap price based on the market and customer demand for lower price is a risk that cannot be left behind. The buy aspect of the decision process does not reveal all the cost pertaining to it, firms only become aware of the transaction cost incurred but there are some cost they regard as irrelevant that contributes to outsourcing cost (Sanders et al., 2007; Raiborn et al.,2009).

Firms involved in the buy aspect of the decision bring about downsizing in the firms. Downsizing is laying off staffs to meet operational cost. In the case of outsourcing, the work that should be done by staffs are outsourced and this renders them underutilized in the firm.

This delve to create mistrust between staffs and firm and can lead to low performance. Employees keep refreshing their knowledge about production process because it something they do continues but when outsourced they lose track of it (Mahmoodzadeh, Jalalinia, and Nekui Yazdi, 2009). Increase in demand for product and services in firm’s requirement are met by the procurement of the requisite materials either internally or externally to meet the alternative possibility of meeting the importance of production of a needed product in a firm. The acquisition of the new product requires knowledge about make or buy decision analysis for decision making with the motive to improve technique (push) and satisfying customers need (pull). Technological improvement can be within the organization and also the fast moving business environment.

Make or buy decision considered critically can yield the following result for firms: lower cost for a given specification, improved technological parameter values giving, better functional performance, greater reliability, increase in scale and miniaturization. Decision makers having a broad idea about the business environment enabling them attain the mentioned benefits, this require firms to analyze both the environment and technology of the firms to determine which process is in accordance with firm's objectives and actions to gain competitive advantage in the market (Kotabe et al., 2008; Lowe 1995).

The common goal of every firm is maximizing shareholders profit through customer satisfaction. This has trigger most firms to involve in make or buy decision, as mentioned above the most common reason is to lower cost and gain higher quality. Companies identify products that are not easy to produce internally to decide upon for higher productivity and effectiveness with higher quality. Making or buying at a lower cost provide firms with the option of acquiring high volume of product which grant them economies of scale. The economy of scale is achievable because the companies have higher volume on their resources, which leads to lower marginal cost. This lower the fixed cost that lead to a lower break-even point on their products. This is an advantage, especially when companies want to improve their financial performance in a short time perspective. (Abrahamson et al., 2003; Gilley and Rasheed, 2000; Alexander and Young, 1996)

IV. MAKE OR BUY DECISION PROCESS

Decision making is an activity that should not be taken for granted, firms can decide daily, periodically or quarterly about their decision making time, some decision can be simple and others might be complicated. Firm decision to either make or buy depends mostly on both the customers and business market as how the trend is moving. The business environment comprise of competitors, suppliers, consumers with the same or similar line of business with the ultimate aim of maximizing profit by reselling or renting (Kotler et al., 2005). This has made it necessary for other firm to engage in other business because of uncertainty and risk (Alpenberg and Karlsson, 2005; Hallgren, 2002).

Bajec and Jakomin (2008), outlined four stages of make or buy decision process, which includes: planning stage, evaluation stage, internal cost and performance analysis and selecting service provider. But this work will focus on eight stages for clarity and understanding of make or buy process. The steps involved give detailed information on how the perceived result will be when the stages are followed critically. In the first stage, the decision making process of a firm comes in different form and it depends on the activity and what the firm want to do before a decision can be taken. The decision might be about large or small quantity of products or services to be decided upon. The decision to either make or buy small quantity are made by either one or few people, the one in charge considers the risk and benefit of the product and arrive at a conducive decision. The making or buying of larger and high impact decisions, usually firms follow a laid down standard method to arrive at a decision. This method is made up of the main stages drawn by the firm to follow (Laios & Moschuris, 2004; Wang et al., 2004).

Also, firm must put the initial stage into consideration, which depict the main goal of engaging in either make or buy. The firm involves all the various departments that are engaged in the production and delivery process. Kotler et al., (2005), pointed out that there is someone or group in a firm that will identity and recognize what product or service a firm should be engaged in. They decide the ultimate process either make or buy which will be profitable to the firm for the firm to embark on it. In this first stage the problem is carefully analyzed, a lot of conceptualization is at this initial stage to avoid a bad decision. Those involved in this process might ask several questions to identify the main aim of the decision such as; identifying the ideal process between make or buy, ascertaining the option that might be problematic, the future direction of the process and the parties involved who might be at a higher risk.

Moreover, Weele (2005), suggested that the first step for engaging in make or buy is to set up a strategic direction to identify company’s activities and core competence. McIvor (2000), deepened it by expressing the essential of decision making and long term strategic decision of a firm. This implies that when make or buy decision is solely based on short term cost, the firm might stand the risk of losing its core competence and competitive advantage (Brown & Wilson, 2005).

Furthermore, since decision making is complex and a delicate process, a lot of knowledge and information relating to make or buy need to be gathered. The information can include what triggers' make or buy decision, this information can be gathered through published papers, advertising papers, consumers, suppliers, competitors etc. In this process of trying to gather information about which decision to take, firms can consult the stakeholders involved in the firm and those in the process of making the choice. For the process of information gathering, tools such as 'check sheets' can be an effective tool. The decision to be taken either to embark on make or buy, should incorporate the firm expectation of the activities of the other party(supplier) and have a fair knowledge about how the supplier perceive your product and relationship with the firm. Buyers should find out about how the supplier judge their relationship (Bonoma, 2006).

In addition to, after the firm has gathered all the necessary data and information for the decision to be taken, there should be a laid down procedure for judging either make or buy is ideal for the firm to embark on. During this process the firm has in mind the main goals and objectives of the firm and it serves as a guideline for a concrete decision making process. Considering maximizing stakeholder's wealth is one of the basic rules that should be considered and with the motive to satisfy customers. Firms always focus on how to make more income and not lost, only in few cases such as non-profit making organizations that do not focus on profit making (Langfield-Smith and Smith, 2003; Poppo and Zenger, 2002).

Again, this step focuses on the firm being able to come up with the knowledge gathered earlier on and selecting the best option. During this stage firms become fully aware of the consequences of the decision to be taken, they understand the effect of the decision and how to handle it. The decision tree model can be used to decide which process is ideal for the firm with less negative impact on the firm (Ho et al., 2003; Helper et al., 2000).

Also, Humphreys et al. (2002), recognizes make or buy as the fundamental process for every firm entering manufacturing. The decision taken by the firm needs to be evaluated after implementation. This requires feedback from both side to know how the process went and what need to be adjusted about it. The evaluation stage becomes the most important part of the decision making process, firms has to incorporate the previous stages and come out with a concrete decision. During this level make or buy will be weighed and decided upon, all their risk and benefits, either useful during long or short term, cost involved, level of competencies needed to embark on the process and capabilities to higher competitive advantage all will be evaluated. Every firm has got its own mode of ruling and deciding on issues and people involved are experience and decisive, those rules need to be enforced for the quality decision to be taken. The firm compares the pros and cons of each stage for effective and quality decision.

Moreover, firm selects the option they want to engage either make or buy after making a critical and effective decision once gone through from step 1 to step 5. In addition, the selection of the best alternative is a well-versed decision since firm has already followed a laid down principle to derive and select the best alternative (Greaver, 1999; Corbett, 2004).

Also, this stage becomes the practical aspect of the decision making process. The firm puts all the analysis made and decision taken into practice. The plan will be carried out and the consequences if any will be revealed for it to be dealt with. The execution stage considers a lot of factors before it can be carried out and control the relationship that exist between firm and external supplier (Nichol, 2009). At this stage, firm comes in term with the other party to carry out the process. Issues such as after sales service, exchange of staffs, price, and termination of process if possible and mode of settlement. The execution process is handled by people with the knowledge and skills to embrace the make or buy process and objectives (Poppo and Zenger, 2002; DiRomualdo and Gurbaxani, 1998; Dyer and Singh, 1998).

Furthermore, decision taken by a firm mostly comes with feedback, this feedback serves as the outcome of the decision taken. The feedback from the decision will be evaluated for firm to know if it was the best decision taken. If there is any changes to be made to the earlier decision, it’s being effected from this level. Decision taken will be unreliable when there is no feedback loop associated. This is one of the best practices that will improve your decision-making skills (Lorenzoni and Lipparini, 1999; Webb and Laborde, 2005; Olson 2007).

According to Ford (2002), firms that are engaged in either make or buy keep track of how the process was carried out with the other parties, the rout informs them whether the decision was fruitful or bad in the short or long term. This indicates that, firm will be pleased or displeased to enter make or buy based on their previous experience with their decision and this will go a long way to influence their production in the future when similar or same process is carried out.

V. DECISION-MAKING POINTS

The decision to make or buy extends beyond manufacturing, encompassing human resources, information technology, maintenance, and other fundamental business functions. Chief procurement officers have a key role to play in helping business units make these decisions given the skills and objective perspective their teams bring to the effort. The results of the quantitative analysis may be sufficient to determine based on the approach that is more cost-effective. At times, qualitative analysis addresses any concerns that cannot be measured specifically. Factors that may influence a firm's decision to buy a part rather than produce it internally include a lack of in-house expertise, small volume requirements, a desire for multiple sourcing and the fact that the item may not be critical to the firm's strategy. Additional consideration may be given if the firm can work with a company that has previously provided outsourced services successfully in the past and can sustain a long-term relationship.

Similarly, factors that may tilt a firm towards making an item in-house include existing idle production capacity, better quality control or proprietary technology that needs to be protected. Concerns regarding the reliability of the supplier may also be considered, especially if the product in question is critical to normal business operations. The firm should also consider whether the supplier can offer a long-term arrangement, if that is desired.

On the academic front, there is an urgent need to explore other hidden dynamics of make-or-buy decisions (especially in a constantly changing global economy) and present time tested and more robust integrated framework to help companies make the right decisions. This integrated framework must be built existing key pillars such as business strategy, risks, economic factors, resource base and other critical factors yet to be discovered.

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