Make vs. Buy
Network for Value Chain Excellence
Training
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Two ongoing questions for a cross-functional team including supply chain, operations, finance, and marketing are:

(1) Which products or services are we currently buying that we should be doing in-house?

(2) Which products and services that we are currently doing in-house should we be buying from suppliers?
A Simple Answer...

Outsourcing
The make or buy decision

MAKE

- Fixed costs
- Labour costs
- Quality control
- Just-in-time

BUY

- Capacity - when needed
- Inventory costs
Key Trends In Outsourcing

• Technology:
  – Innovations like Cloud Computing and Business Process as a Service (BPAS) driving growth

• Location Strategy:
  – Developed countries expecting 15%-27% growth
  – Developing countries high growth rate – 2X current base

• Legislation and Regulation:
  – Companies not in favor of regulation limiting outsourcing – if enacted, firms will pass costs to customers or absorb
  – Data security issues may reduce outsourcing
  – The current and future political environments uncertain

• Supply Chain’s outsource management capability maturing

Source: Deloitte’s 2014 Global Outsourcing and Insourcing Study
Outsourcing Locations

Source: Deloitte’s 2014 Global Outsourcing and Insourcing Study
Make or Buy Insourcing and Outsourcing Decisions

Business Opportunity

Execution

Later Review

What Product / Service to Create in What Market Segment(s)?

What Do We Make or Buy?

100% Make

Gray Zone

100% Buy

Later Review

Stay

Change

Stay

Change

Stay

Change

Stay

Change

100% Make

100% Buy

100% Make

100% Buy

100% Make

100% Buy
3 Key “Pillars” of the Make vs. Buy Decision

• Business Strategy
• Risks
• Economic Factors
Business Strategy

- **Strategic importance** to the company of the product or service that is being considered for outsourcing - process, technologies, or skills required to produce.
- Factors must be considered in light of the current competitive environment and in anticipation of how that environment might change in the future.
- As a rule, it’s desirable to choose in-house capabilities when:
  - A product or a function is critical to a company’s performance
  - Function is considered a core competency/capability
Business Strategy (Cont.)

• Outsourcing tends to be a good choice when companies are seeking to:
  – Eliminate the burden of capital or labor-intensive processes on the balance sheet
  – Reduce costs
  – Gain flexibility to adjust output in response to changing demand
  – Phase out management of transactions or training
  – Supervise fewer workers
  – Gain access to new process or technologies
  – Leverage external expertise
Risks

• Lower quality, reliability and predictability
• Escape of intellectual property
• Unstable political environment
• Concerns with social or environmental factors
• Reputational risk
• Selecting the right supplier and structuring an effective ongoing relationship
“Hold-Up” Risks

• Giving too much leverage to an outsource supplier puts a firm at risk.

• Examples of how to mitigate “hold-up” risk:
  – Control production through direct ownership or joint venture
  – Multiple suppliers for each product or service with significant “hold-up” potential
  – Select one supplier for each product or service - split overall volume across suppliers to stimulate competition
  – Create situation with shared incentives for customer and supplier
Economic Factors

• Impact of outsourcing on capital expenditures
• Return on invested capital
• Return on assets
• Savings achieved through outsourcing
• Total cost must be used to evaluate an outsource solution such as:
  – Shipping and handling
  – Expanded inventories
  – Administrative expenses, such as supplier management and quality control
Role of Supply Chain Leadership

• Supply chain leaders - expertise in selecting third-party suppliers to generate the highest possible level of quality and productivity
  – Must play a leadership role in the decision making process to Make or Buy

• Usually no direct operational responsibility - able to provide an unbiased evaluation

• Responsible to ensure the right trade-offs have been evaluated and all the possibilities have been considered
  – If the firms internal capabilities below global benchmarks? Can they be improved?
  – Does better innovation and technology exist in the supply base than the firm possess and can they improve?
  – Are the firms processes and systems inefficient and ineffective? – do not outsource a poor process!
### Six Make-or-Buy Assessments

<table>
<thead>
<tr>
<th>Assessments</th>
<th>Question</th>
<th>Possible outcomes</th>
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<tbody>
<tr>
<td>1. Manufacturing strategy compatibility</td>
<td>Does the product fit within the manufacturing strategy?</td>
<td>Make in-house</td>
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<tr>
<td>2. Total delivered costs</td>
<td>How do internal costs compare with third-party alternatives?</td>
<td>Invest to make in-house</td>
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<td>3. Capacity</td>
<td>Is there available or potential plant capacity for in-house manufacturing?</td>
<td>Buy from contract manufacturer</td>
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<td>4. Intellectual property exposure risk</td>
<td>What is the intellectual property risk of buying a product?</td>
<td>Invest to buy from contract manufacturer</td>
</tr>
<tr>
<td>5. Business case</td>
<td>What is the business case for making or buying a product?</td>
<td>Redefine or do not make the product</td>
</tr>
<tr>
<td>6. Contract manufacturers availability</td>
<td>Are there contract manufacturers available to make the product?</td>
<td></td>
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</tbody>
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Source: A.T. Kearney analysis
Example Make-or-Buy Decision Tree

1. **Is the capacity available in-house?**
   - **Yes**: Make in-house
   - **No**: Is making in-house cost-competitive?
     - **Yes**: Is there a strong business case for making in-house?
       - **Yes**: Are contract manufacturers available?
         - **Yes**: Is there a strong business case for the product? (Redefine or do not make the product)
         - **No**: Buy from contract manufacturer
       - **No**: Is there a business case for making the product?
         - **Yes**: Are contract manufacturers available?
           - **Yes**: Is there a business case for the new product? (Redefine or do not make the product)
           - **No**: Buy from contract manufacturer
         - **No**: Redefine or do not make the product
     - **No**: Is making in-house cost-competitive?
       - **Yes**: Invest to make in-house
       - **No**: Does the product meet the manufacturing strategy?
         - **Yes**: Buy from contract manufacturer
         - **No**: Redefine or do not make the product

2. **Does the product meet the manufacturing strategy?**
   - **Yes**: Buy from contract manufacturer
   - **No**: Invest to make in-house

Source: A.T. Kearney analysis
After the Outsource Decision is Made...

• Once the decision is made, supply chain must work with their partners to select the best supplier(s) and manage the implementation

• Key suppliers attributes must be assessed:
  – Business strategies
  – Financial health
  – Management team capabilities
  – Manufacturing and engineering capabilities
  – Design and innovation skills
  – Supply chain skills
  – Labor costs
  – Staff skills and employee training programs
  – Ability to scale
  – Capacity utilization
  – Social policies
Management of the Outsource Firm

• Develop an organization to manage the 3rd party
  – Supply chain, engineering, manufacturing, finance...

• Deploy resources to the supplier’s site(s) if necessary

• Active management of the supplier
  – Development and ongoing review of key metrics
  – Frequent joint operations management meetings
  – Regular joint executive reviews of supplier performance and strategic alignment
Reasons to Insource

• The necessity argument: “We would prefer not to produce this product or service in-house, but we really don’t have any other options.”

• The opportunity argument: “We would prefer to do this in-house because it would give us a strategic competitive advantage.”
Insourcing Drivers

Source: Deloitte’s 2014 Global Outsourcing and Insourcing Study
Examples of Necessity Drivers of Insourcing

• Anything that threatens assurance of supply
  – An existing source of supply goes out of business or drops a product or service line and no other supplier is available
  – No opportunities for supplier development
  – A sudden massive increase in price
  – The purchase of a sole source by a competitor
  – Political events and regulatory changes
  – Lack of supply of a key raw material or component required for the manufacture of the purchased product
What can you do starting today?

• Understand the capabilities of the outsource suppliers that support your categories – ongoing scan

• Working with your stakeholders and Finance, benchmark the supplier’s costs and capabilities against your firms internal costs and capabilities

• Determine a decision making process to evaluate if investing to keep the process in-house is more valuable than outsourcing
Questions?
Sources

• Make vs. Buy Revisited: Reassessing your company’s manufacturing strategy (A.T. Kearney, 2010)
• Make or Buy: Three pillars of sound decision making (Strategy&, 2011)
• Deloitte’s 2014 Global Outsourcing and Insourcing Survey (December 2014)