Article review

Make or buy decisions

Group 9

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Article topics on make or buy decisions can be divided under two broader themes

**Transaction cost economies**
- Transaction costs in make/buy/ally decisions - Valtteri
- Compensation systems’ effect on make/buy/ally decision - Lars

**Outsourcing of companies’ activities**
- Invisible costs in offshoring services - Lassi
- Outsourcing supply management - Eliel
Transaction costs in make/buy/ally decisions
Transaction costs in make/buy/ally decisions

“Central question of transaction cost theory is whether a transaction is more efficiently performed within a firm or outside it”

- **Purpose** to synthesize and evaluate transaction cost–based research on make, buy, or ally decisions
- **A quantitative meta-analysis** on 200 empirical papers
- **Research questions:**
  - How transaction dimensions (asset specificity; volume, technological, and behavioural uncertainty) affect the preferred **governance choice** (make, buy, or ally)
  - Does appropriate governance choice lead to **enhanced performance**?
Transaction costs in make/buy/ally decisions

Main findings

• Asset specificity, and volume and behavioural uncertainty promote a choice of “make”, whereas technological uncertainty promotes “buy”

• No evidence that asset specificity has stronger predictive power than uncertainty

• Governance choices appropriately aligned with transaction dimensions lead to enhanced performance (cost savings)

Key learnings

• The uncertainty in make or buy decision can be ex ante (difficulties in adjusting agreements) or ex post (whether contract has been fulfilled)

• Various transaction dimensions create “market failure”, making vertical integration (“make”) more efficient than market governance (“buy”)
Compensation systems’ effect on make/buy/ally decision
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**Purpose** to understand what effect do TCE variables and compensation systems have on the outcome of make-or-buy decision

**Research question**
- Which one better predicts make-or-buy decision outcomes or them together

**Survey** to purchasers, engineers and marketers
- Purchasers and marketers considered as similar from compensation perspective
- Mainly Earth-Moving equipment and Automotive industries component procurement

9 hypothesis, 6 on TCE variables ja 3 on compensation systems
Compensation systems’ effect on make/buy/ally decision

Main Findings
• Being compensated for implementing close relationships leads to increasing joint action
• Being compensated for choosing suppliers based on price only leads to decreasing joint action
• TCE hypothesis were not supported
  - Component make-or-buy decisions are not considered as being strategic enough?

Key Learnings
• Compensation systems have the desired outcome
• Compensation system have to be aligned with organizational goals
• TCE model is incomplete
Invisible costs in offshoring services work
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Offshoring of services can provide several advantages
• Lower costs, skills and knowledge, 24/7 support for customers

Offshoring decisions usually made on the basis of visible costs
• Wages and other labour costs, labour turnover rate, infrastructure...

However, also invisible costs exist
• For example, foreign understanding of domestic business environment and expectations might be poor
  → Risk of losing customers if their experience of offshored services is negative

Purpose to identify drivers of these costs and find ways for controlling and attenuating invisible costs in offshoring services work
Key learnings

- Geographic distance
- Language distance
- Cultural distance

Interaction distance to offshore locations

Interaction intensity

Invisible costs

Service content

Service process
If there is a wrong combination of interaction distance and intensity when the service is offshored, either costs savings may be too low or invisible costs too high.
Outsourcing supply management
Outsourcing supply management

• **Purpose** to gain knowledge of outsourcing purchasing activities, for which there is increasing interest

• Research questions:
  
  **RQ1**: What purchasing-related activities are more effectively performed externally?
  **RQ2**: What purchasing-related activities are more effectively performed internally?
  **RQ3**: Is outsourcing an opportunity or a hazard for supply management?

• Fixed-alternative survey of the supply management of 126 organisations (US Fortune 1000)
  
  – 20 performance measures
  – Strategic vs. non-strategic purchases
Outsourcing supply management: findings

• In **strategic** purchases, internal purchasing outperforms third parties in terms of
  • Participation in formulating corporate strategy
  • Coordinating with other functions, integrating with corporate systems
  • Price
  • Implementing supplier relationships
  • Ability to respond to changes in market and technology

• In **non-strategic** purchases, no significant difference in performance was perceived

• Learnings
  – The same principles apply as in any outsourcing decision
  – The purchasing function cannot be entirely outsourced
  – With the right balance, outsourcing can be an opportunity if purchasing resources are limited
Key takeaways

Many different factors (e.g. uncertainties) affect the preferred choice in make or buy decisions

• Internal compensation systems also have an impact on the decision

• Better make or buy decisions often lead to enhanced performance (e.g. cost savings)

Offshoring of services work is crucial to be considered in terms of interaction distance and intensity

Outsourcing of supply management is hazardous

• Opportunity for firms with limited resources
Thank you!

References:


