

Pillars

1. Business Strategy

- Attractiveness of the product or service needs to be evaluated from a customer perspective.
- Criticality for the overall business success :
 - Proprietary of product
 - Product differentiation
- Industry dynamics and the competitive positioning of the company regarding the product.
- Dynamics of technology or capability
 - Rate of change.
 - Risk of core capability.
- As a rule, it is desirable to choose MAKE when the product is critical for the company's success or is considered a core operation
- Conversely outsourcing is strategically advisable if:
 - Eliminate the burden of capital-intensive processes
 - Reduce cost
 - Gain flexibility to adjust output
 - Leverage external expertise

Make (In-house)

- In-house process differentiates the product or service.
- Capability used for the new product or service has synergies across the business.
- Supply market is hostile or controlled by competitors
- Need to... push the technology into the market

Buy

- Process/business is not attractive (i.e. hard to find workers, strict regulatory environments, ...)
- Product/service are not critical to end products or marketing efforts.
- Supply market is suitable for building close partnerships.
- Suppliers are willing & able to meet innovation needs.

Process / or Product

Future competitive advantage or emerging technology?

No

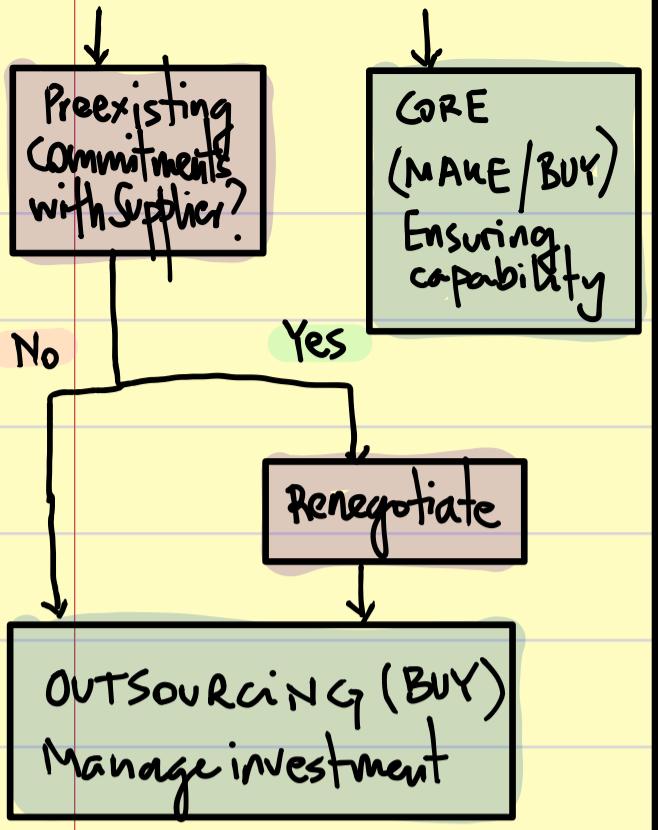
Core critical

Yes

STRATEGIC
(MAKE)

No

Yes



2. Risks

- Availability of alternative sources and switching costs.
(Remember that the supply chain networks are dynamic and are subject to change).
- Supply market risks (if foreign-sourced):
 - Political stability
 - Exchange-rate volatility.
- Transportation risks:
 - Lead time
 - Supply chain disruption.
- Intellectual property protection
- Risks include lower quality, reliability, and predictability of outsourced products/services as compared with in-house products.

MAKE

- Few or no alternative sources of supply.
- High supply market risk.
- Imperative to couple supply and usage (i.e. if a short lead time is needed) for quick response and quality.
- Sensitive intellectual property involved.

BUY

- Holdup risk is low or sufficiently managed through contract or broader business relationship.
- Low switching costs and easily accessible alternative sources of supply.
- Uncoupling the supply chain has little or no impact.
- No sensitive intellectual property involved.

- Risks inherent in the process of identifying and selecting the right supplier and structuring a workable ongoing trustworthy relationship.

- When there are multiple suppliers, a single failure in the chain may not be fatal, but BUY strategies bring a number of risks and the evaluation should be carefully done.

3. Economic factors

- Relative economic and operating performance advantage.
 - Scale the business?
 - Increase utilization?
 - Reliability (TRUST) of our suppliers.
 - Cost factors?
 - Quality issues?
 - Calculate the capital requirements and financial returns (Break Even Point)
 - Level of expertise necessary.

MAKE

- Internal cost advantage or cost parity, high quality
- Significant recent investment in process technology that cannot be recovered.
- Investments meet required return on invested capital (ROI).
- Company has a strong, defensible skills base.

BUY

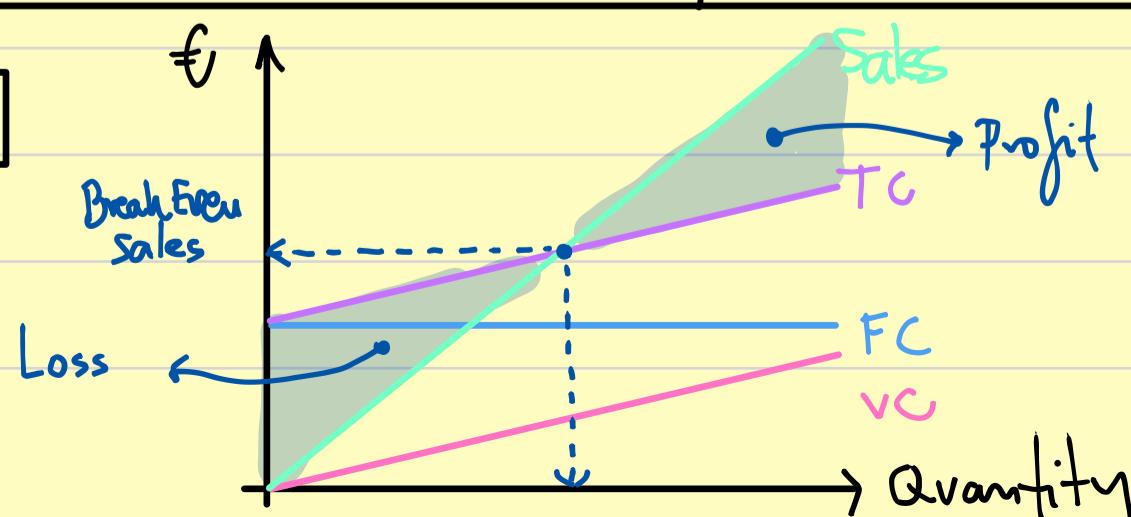
- Supplier have low costs (\downarrow OVERALL SUPPLY CHAIN COST) or better quality.
- Major new investments are required.
- Suppliers have lower ROI targets.
- Insufficient in-house skills or are difficult to acquire.

BREAK-EVEN-ANALYSIS

Parameters:

Total Cost (TC)

Variable Cost (VC)



Fixed Cost (FC)

$$TC = VC + FC$$

Break Even Point (BEP)

$$BEP = \frac{\text{Fixed Cost}}{\text{Selling Price} - \frac{\text{Variable Cost}}{\text{Unit}}}$$

Example: A firm buys a product for 500 € each.

In case they make it, the fixed cost is 4.000.000 €

and the variable cost is 300 €/unit. Demand is 1500 units.

More?

Selling price = 500 €/unit

Variable cost: 300 €/unit

Fixed cost: 4.000.000 €

$$BEP = \frac{4.000.000 \text{ €}}{500 \text{ €} - 300 \text{ €}} = 20.000 \text{ Units}$$

Since demand is only 1500 units is less than the BEP, the company should NOT buy the product. We lose money if we MAKE because we don't achieve BEP.

