

# MAKE / BUY DECISIONS

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## The phenomenon

# HARRY'S



Wharton startup founded in 2013 buys a 93 year old German razor blade manufacturing factory (*Feintechnik*) in 2014 for \$100M

## What are the entrepreneurial benefits of “buying” from others?

- Avoid duplicative investments
  - Especially if there is a competitive external supply
- Division of labor according to comparative advantage
  - Entrepreneurial firms may be better at upstream innovation
  - Established industry incumbents may have a more established supply chain, often with **economies of scale** in production
- Pay for results rather than paying for effort
  - Especially important when the production process is uncertain

## Transaction costs associated with “buying” / partnering

- Factors raising transaction costs
  - The **specificity** of the investments required to conduct the transaction
  - The **complexity** of the transaction and the **uncertainty** about what performance will be required
  - The **difficulty of measuring performance** in the transaction
- Factors lowering transactions costs
  - The **frequency** with which transactions occur and the **duration** over which they are repeated
  - The **connectedness** of the transaction to other transactions involving other people

## Nobel prizes in economics awarded for these concepts

- 1991 prize to Ronald H. Coase *"for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy."*
  - [http://www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/1991/](http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1991/)
- 2009 prize was divided equally between Elinor Ostrom *"for her analysis of economic governance, especially the commons"* and Oliver E. Williamson *"for his analysis of economic governance, especially the boundaries of the firm"*.
  - [http://www.nobelprize.org/nobel\\_prizes/economic-sciences/laureates/2009/](http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2009/)

## What are the entrepreneurial benefits of “making”?

- Avoid transaction costs
  - Contracting frictions and threat of hold-up
- Control aspects
  - Value of organizational “fiat”
  - Learning curves
  - Not reliant on outsiders, especially important if you require specific investments by supplier (unless you are large enough!)



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