Chapter 10

OUTSOURCING

BA 477 Purchasing and Supply Management

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LEARNING OBJECTIVES

1. Learn why companies outsource, besides for cost reduction.
2. Understand the trade-offs between in-house production and subcontracting/outsourcing.
3. Understand the dynamics of the make-or-buy decision.

OUTSOURCING AND SUPPLY MANAGEMENT

- Outsourcing has become a way to increase an organization's flexibility to meet rapidly changing market conditions, focus on core competencies and develop competitive advantage.

OUTSOURCING: A GROWTH INDUSTRY

- Outsourcing is increasing rapidly
  - Not just materials, many business functions are being outsourced
- Outsourcing can enable:
  - Leveraging of the supplier's expertise
  - Increases in innovation
- And result in:
  - lower staffing levels
  - reduced costs
  - more flexibility

STRATEGIC ISSUES

- Core Competencies
  - What are they today? Tomorrow?
  - Results in horizontal integration – "virtual corporation"
- Supplier Dominance
  - Potential lock-in by supplier
- The Creation of Strategic Vulnerabilities
  - What you outsource becomes generic – not a competitive advantage
  - You are sourcing from firms that supply your competitors
- The Dangers of Vertical Integration
  - Can reduce flexibility and responsiveness

HORIZONTAL INTEGRATION

- Sometimes referred to as a "virtual corporation"
- Involves outsourcing nearly everything except a few core activities.
- Cisco example –-

FROM A STRATEGIC LEVEL: WHAT SHOULD NOT BE OUTSOURCED

1. An item that is critical to the success of the product
2. An item that requires specialized design, manufacturing skills or equipment
3. An item that fits well within the firm's core competencies

CONSIDERATIONS WHICH FAVOR MAKING

1. Cost considerations
2. Desire to integrate plant operations
3. Use of excess plant capacity
4. Control over production and/or quality
5. Design secrecy required
6. Unreliable suppliers
7. Desire to maintain a stable work force

CONSIDERATIONS WHICH FAVOR BUYING

1. Limited production facilities
2. Cost considerations (less expensive to buy)
3. Small-volume requirements
4. Suppliers' specialized know-how
5. Stable work force (rising sales)
6. Multiple-source policy
7. Indirect managerial control considerations
8. Procurement and inventory considerations

MAJOR ELEMENTS INCLUDED IN A "TO MAKE" COST ANALYSIS

1. Delivered purchased material costs
2. Direct labor costs
3. Any follow-on costs stemming from quality and related problems
4. Incremental inventory carrying costs
5. Incremental factory overhead costs
6. Incremental managerial costs
7. Incremental purchasing costs
8. Incremental costs of capital

MAJOR ELEMENTS INCLUDED IN A "TO BUY" COST ANALYSIS

1. Purchase price of the part
2. Transportation costs
3. Receiving and inspection costs
4. Incremental purchasing costs
5. Any follow-on costs related to quality, service, inventory.

CAPACITY AND COST CONSIDERATIONS

- 2 possibilities
  - 1. We are at capacity
    - Fixed costs are an issue
  - 2. We are not at capacity
    - Fixed costs are not as much an issue

NETSOURCING

- Many companies are not readily staffed to keep a company competitive in e-business
- As a result, companies are outsourcing infrastructure development and maintenance to "Netsourcers"
- Netsourcing has become popular since it allows:
  - A quick e-business presence
  - Flexibility to make changes
  - Sustained performance
  - Support without the need to train or hire specialized personnel

THE VOLATILE NATURE OF THE MAKE-OR-BUY DECISION

- The make-or-buy question is influenced by a multitude of diverse factors constantly changing

DANGERS OF OUTSOURCING SUMMARY

- Loss of control
- Loss of client focus (if outsourcing customer touching processes)
- Loss of cost control
- Loss of confidentiality
- Double outsourcing

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TAKEAWAYS

1. Firms are becoming more aware of the strategic dimension of the make-or-buy decision – no longer a cost issue only.
2. As technology has advanced, most manufacturing firms have become much more specialized, pushing firms to outsource.

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